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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 600

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

MOUNTAIN PRODUCERS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 24, 1937
CERTIORARI GRANTED JANUARY 3, 1938

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A Caption omitted.

1 Before United States Board of Tax Appeals

Docket No. 44573

MOUNTAIN PRODUCERS CORPORATION, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Petitioner: Randolph E. Paul, Esq., Harold D. Roberts, Esq., Chas. B. McInnis, Esq. For Respondent: R. P. Hertzog, Esq., C. N. Kitchen, Esq., V. G. Weekley, Esq.

Docket entries

1929

May 13—Petition received and filed. Taxpayer notified. (Fee paid.)

May 14—Copy of petition served on General Counsel.

June 29—Answer filed by General Counsel.

July 2—Copy served on taxpayer—assigned General Calendar.

1931

Nov. 18—Hearing set Feb. 4, 1932.

1932

Jan. 18—Motion for 90 days continuance filed by taxpayer. 1/20/32 granted to May 4, 1932.

April 26—Motion for 90 days continuance filed by taxpayer. 4/27/32 granted to Fall, 1932.

Sept. 13—Hearing set Oct. 27, 1932.

Oct. 8—Motion for 60 days continuance filed by taxpayer. 10/11/32 granted to Dec. 15, 1932.

Dec. 2—Motion for a continuance of 60 days filed by taxpayer. 12/5/32 granted to Feb. 15, 1933.

1933

Feb. 3—Motion for continuance of 90 days filed by taxpayer. 2/6/33 granted to May 15, 1933.

May 6—Motion for continuance to Fall Calendar filed by taxpayer. 5/10/33 granted.

2 1933

Nov. 25—Motion for leave to amend petition, amendment tendered, filed by taxpayer. 11/29/33 granted. 12/5/33 copy served.

1934

Jan. 16—Hearing set 2/19/34.

Jan. 23—Answer to amend petition filed by General Counsel.

Jan. 29—Copy of answer served.

Jan. 30—Motion for circuit hearing at Denver filed by taxpayer. 1/31/34 granted.

Jan. 10—Motion for hearing in Washington, D. C., filed by taxpayer. 1/11/35 granted.
Jan. 10—Stipulation of facts filed.
Jan. 11—Hearing set Jan. 30, 1935.
Jan. 30—(Held over Jan. 31) Hearing had before H. F. Seawell, Division 4. Submitted on merits. Amendment to answer to amended petition, and supplemental stipulation of facts, also appearances of Mr. Roberts and Mr. McInnis. Petitioner's brief due in 40 days (March 12, 1935)—respondent's due 20 days after.
Feb. 2—Second supplemental stipulation of facts filed.
Feb. 6—Transcript of hearing of 1/31/35 filed.
March 9—Motion for extension of 10 days to filed brief filed by taxpayer. 3/12/35 granted to 3/22/35.
March 21—Brief filed by taxpayer. 3/21/35 copy served.
April 10—Brief filed by General Counsel.
April 22—Motion for extension to April 30, 1935, to file reply brief filed by taxpayer. 4/22/35 granted.
April 30—Reply brief filed by taxpayer. 5/1/35 copy served.

1936

April 23—Findings of fact and opinion rendered—Mr. Seawell, Division 4. Decision will be entered under Rule 50.
June 3—Notice of settlement filed by General Counsel.
June 5—Hearing set June 24, 1936, on settlement.
June 24—Hearing had before Mr. McHahon (Seawell) on settlement under Rule 50—not contested—petitioner agrees to respondent's recomputation—referred to Mr. McMahon for decision.

3 1936

June 24—Decision entered—S. J. McMahon, Division 16.
Sept. 14—Petition for review by U. S. Circuit Court of Appeals, 10th Circuit, with assignments of error filed by taxpayer.
Sept. 14—Proof of service filed by taxpayer.
Nov. 12—Motion for extension to 12/15/36 to prepare and transmit record filed by taxpayer.
Nov. 12—Order that time for preparation of evidence and transmission and delivery of record be extended to Dec. 15, 1936, entered.
Dec. 11—Agreed statement of evidence lodged.
Dec. 11—Praecipe filed with proof of service thereon.
Dec. 12—Agreed statement of evidence approved and ordered filed.
Dec. 14—Order enlarging time to Jan. 15, 1937, for transmission and delivery of record entered.

Before United States Board of Tax Appeals

Petition

Filed May 13, 1929

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated March 14, 1929, and as a basis of its proceeding alleges as follows:

I. The petitioner is a Delaware corporation with its principal office at 808 First National Bank Building, Denver, Colorado.

II. The notice of deficiency, a true copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on March 14, 1929.

III. The taxes in controversy are income and excess profits taxes for the calendar year 1925 and are for $90,642.87, the total amount of the deficiency being in controversy.

IV. The determination of tax set forth in said notice of deficiency is based upon the following error:

(a) Increase of taxable net income of $621,341.94 occasioned by the disallowance of depletion in the amount of $621,341.94 representing the difference between the amount of depletion claimed in the return filed, $2,296,019.86, and the amount of the depletion allowed, $1,674,677.92, the basis for such depletion claimed in the return having been changed by the Commissioner of Internal Revenue.

The decrease of depletion referred to is based upon an incorrect interpretation and application of Section 204 (c) (2) of the Revenue Act of 1926 in that the Commissioner has taken 27½% of the taxpayers' alleged gross income instead of 27½% of the gross income from the property irrespective of ownership, the correct depletion being as hereafter alleged.

V. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) The Wyoming Associated Oil Corporation is and was, at all times hereinafter mentioned, a Delaware corporation with its principal office at 608 First National Bank Building, Denver, Colorado.

(b) During the year 1925, the petitioner was affiliated in a Class "A" relationship with the Wyoming Associated Oil Corporation, within the purview of Section 240 of the Revenue Act of 1926.

(c) In its 1925 return, the Wyoming Associated Oil Corporation claimed depletion on its depletable oil properties in the sum of $2,215,862.23; depletion on state lands amounting to $80,157.63 was not claimed in the return nor was the income from such state lands included in the return.

(d) On the same depletable properties (including state lands), the Commissioner of Internal Revenue has allowed depletion (as indicated in the 60-day letter) in the amount of $1,674,677.92.

(e) The depletable properties of the Wyoming Associated Oil Corporation upon which depletion is allowable for the year 1925 are set forth in Exhibit B attached hereto and incorporated herein by reference as if specifically set forth.

(f) The depletion allowed by the Commissioner of Internal Revenue is as follows:

Trace	Amount of depletion allowed
W½ 12, NW & N½ SW 13–40–79	$82,539.29
S½ SW 13	13,053.35
S½ SE & NW SE 14	46,905.96
SW 14	68,742.18
5 S½ NW & NW NW 14	53,768.70
NE 15	27,143.12
E½ NE SE 15	3,803.32
S½ SE 22	66,202.62
E½ NE 23	45,314.02
NE SE & SW SE 23	40,223.32
SE SW 23	16,310.49
SW SW 23	4,072.80
NE 24	69,541.90
N½ SE 24	56,732.93
N½ SW 24	18,477.22
NW 24	111,392.11
E½ 25	88,706.19
S½ SW 25	30,081.86
W½ NE 26	20,922.59
SE SE 26	13,233.30
SW SE 26	23,137.35
S½ SW 26	8,799.16
E½ NW 26	57,891.09
W½ NW 26	65,657.02
N½ NE 27	42,779.97
S½ NE 34	22,624.25
N½ SE & N½ SW SE 34	41,641.59
S½ NW 34	11,932.18
SE 35	96,568.22
NW 35	97,230.54
All of Sec. 36	45,927.12
N½ SW NW 19–40–78	12,399.91
S½ SW NW 19	9,552.10
SW SE 30	14,995.50
NW SE 30	27,821.04
NE SW & S½ SW 30	39,394.76
NW SW 30	20,440.21
S½ SW NW 30	39,997.20
NW NW & N½ SW NW 30	5,668.43
S½ NW & NW NW 1–39–79	25,082.89
NE 2	80,275.86
SW NW 5–39–78	335.29
600 acres in Sec. 6	7,358.97
Total	1,674,677.92

6 (g) The correct depletion of said depletable properties for the year 1925 is as follows:

Tract	Correct amount of depletion
W½ 12, NW & N½ SW 13–40–79	$108,819.18
S½ SW 13	22,709.86
S½ SE & NW SE 14	65,689.20
SW 14	68,742.18
S½ NW & NW NW 14	55,499.04
NE 15	47,757.92

Tract	Correct amount of depletion
E½ NE SE 15	$6,481.68
S½ SE 22	66,202.62
E½ NE 23	45,314.02
NE SE & SW SE 23	65,424.13
SE SW 23	17,636.90
SW SW 23	4,072.80
NE 24	121,797.28
N½ SE 24	100,145.79
N½ SW 24	18,477.22
NW 24	112,899.12
E½ 25	155,757.41
S½ SW 25	30,081.86
W½ NE 26	36,755.73
SE SE 26	23,070.67
SW SE 26	40,547.88
S½ SW 26	15,551.54
E½ NW 26	101,890.20
W½ NW 26	87,434.01
N½ NE 27	42,779.97
S½ NE 34	33,807.57
N½ SE & N½ SW SE 34	47,707.01
S½ NW 34	11,982.18
SE 35	113,916.43
NW 35	171,788.84
All of Sec. 36	70,842.65
N½ SW NW 19–40–78	21,815.03
S½ SW NW 19	16,485.40
SW SE 30	26,147.59
NW SE 30	47,565.34
NE SW & S½ SW 30	69,713.91
NW SW 30	35,014.52
S½ SW NW 30	9,750.92
NW NW & N½ SW NW 30	70,527.46
7 S½ NW & NW NW 1–39–79	44,091.78
NE 2	113,841.43
SW NW 5–39–78	335.29
600 Acres in Sec. 6	7,358.97
Total	2,374,180.53

(h) Under date of July 18, 1919, the Wyoming Associated Oil Corporation entered into a contract with the Midwest Refining Company by the terms of which the oil lands of the Wyoming Associated Oil Corporation situated in the Salt Creek Oil Fields, Natrona County, State of Wyoming, were subjected to certain rights and privileges granted to the Midwest Refining Company including the right from June 1, 1919, to January 1, 1934, to work such lands and extract oil therefrom, said oil to be paid for at prices indicated in the contract.

(i) A true copy of said contract of July 18, 1919, is attached hereto as Exhibit C.

(j) The gross production in barrels, less Government royalties, the royalties in barrels paid by the Wyoming Associated Oil Corporation, the royalties in barrels paid by the pipe line companies and the net production in barrels from the depletable properties of the Wyoming Associated Oil Corporation for the year 1925 was as set forth in Exhibit D attached hereto, the figures in such exhibit being specifically incorporated herein.

(k) Depletion based on 50% of the net income of the Wyoming Associated Oil Company from the depletable properties amounts to $2,296,711.14, the said amount being made up as set forth in Exhibit E attached hereto, the facts and figures in said exhibit being specifically incorporated herein.

(l) The cost depletion of the depletable properties of the Wyoming Associated Oil Corporation for the year 1925 is as set forth in Exhibit F attached hereto, the facts and figures in said exhibit being specifically incorporated herein.

(m) The gross income from the depletable properties of
8 the Wyoming Associated Oil Corporation for the year 1925 was $9,669,686.08, which gross income is in the amounts stated in Exhibit G attached hereto, the facts and figures in said exhibit being specifically incorporated herein.

(n) The net income of the petitioner for the year 1925 derived from said depletable properties (computed without allowance for depletion) was $4,593,422.28.

VI. Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the 27½% limitation on the amount of the depletion be figured on the basis of the gross income from the properties as set forth in the preceding petition and to give such other and further relief as may seem proper and advisable to this Board.

Respectfully submitted.

RANDOLPH E. PAUL,
Attorney for Taxpayer, 15 Williams St., New York, N. Y.

[Duly sworn to by John T. Barnett; jurat omitted in printing.]

Exhibit A to petition

TREASURY DEPARTMENT,
WASHINGTON, *Mar. 14, 1929.*

MOUNTAIN PRODUCERS CORPORATION,
608 First National Bank Building, Denver, Colorado.

SIRS: In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the year 1925 discloses a deficiency of $90,642.87, as shown in the statement attached.

9 The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

However, If You Do Not Desire to Petition, you are requested to execute the inclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges,

since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; Whereas If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,

D. H. BLAIR,
Commissioner.
By C. B. ALLEN,
Deputy Commissioner.

Inclosures: Statement, Form 866, Form 882.

STATEMENT

IT:AR:G-1.
FPN-60D.

Returns examined

Company	Year	From—
Mountain Producers Corporation	1925 1925	1120 (Tentative). 1120 (Original).

This office holds that you are affiliated in a Class A relationship with the Wyoming Associated Oil Corporation for the year 1925, within the purview of Section 240 of the Revenue Act of 1926.

TAX LIABILITY

Company, Mountain Producers Corporation; year, 1925; deficiency, $90,642.87.

In accordance with the agreement to assessment under the provisions of Section 240 (b) of the Revenue Act of 1926, executed by you on January 24, 1929, and filed with this office, the entire tax liability of the consolidated group is assessed against the Mountain Producers Corporation.

The adjustments hereunder are based upon information contained in the Revenue Agent's report covering the year 1925, a copy of which has been furnished you, and other data on file in this office.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1925, the Bureau will be unable to afford you an opportunity under the provisions of Article 1211, Regulations 69, to discuss your case before mailing formal notice of its determination as provided by Section 274 (a) of the Revenue Act of 1926. It is, therefore, necessary at this time, in order to protect the interests of the Government, to issue this formal notice of deficiency.

Payment should not be made until receipt of notice and demand from the Collector of Internal Revenue for your district, and remittance should then be made to him in accordance with the provisions of his notice.

Mountain Producers Corporation. Year ended December 31, 1925.

SCHEDULE 1.—NET INCOME

Net loss as disclosed by return		$ 23,331.10
As corrected (Net loss)		23,281.10
Adjustment: (a) Donations disallowed		$ 50.00

(a) Donations are not an allowable deduction from gross income in arriving at the taxable income.

SCHEDULE 2.—NET INCOME

Net income as disclosed by return		$2,110,579.75
As corrected		2,807,782.57
Net adjustment		$ 697,202.82
Unallowable deductions and additional income:		
(a) Prior year adjustment	$ 2.08	
(b) Prior year adjustment	1,867.47	
(c) Depletion disallowed	541,184.31	
(d) Income from State lands restored	185,438.83	
Total		$ 728,492.69
Nontaxable income and additional deductions:		
(e) Prior year adjustment	$2,121.21	
(f) Taxes on State Lands allowed	5,602.81	
(g) Royalties on State Lands allowed	18,431.11	
(h) Interest on United States obligations exempt	2.08	
(i) Capital stock tax adjustment	167.00	
(j) Adjustment of income from A. D. Aitken, Trustee	4,965.66	
Total		$31,289.87
Net adjustments as above		$697,202.82

EXPLANATION OF ITEM CHANGED

(a) This item was allowed as a deduction in 1922, the year to which it is applicable.

(b) This item was allowed as a deduction in 1924, the year to which it is applicable.

(c) The depletion allowance is adjusted as follows:

Depletion claimed	$2,215,862.23
Depletion allowed	1,674,677.92
Depletion disallowed	[1] $541,184.31

[1] As in the 60-day letter; see, however, Revenue Agent's report showing disallowance.

The computation of the depletion allowance is shown in detail in the Revenue Agent's report.

(d) The Bureau holds that income from leases of which the State of Wyoming is the owner and lessor, is income subject to tax.

(e) This item was taken into consideration in determining the taxable income for 1923.

(f) and (g) Taxes and royalties relative to income from leases of which the State of Wyoming is the owner and lessor, are allowed as deductions, inasmuch as such income has been restored under (d) above.

12 (h) Exempt interest on United States obligations is eliminated.

(i) Net amount of claim for refund of capital stock taxes of $167.00, debited to accounts receivable and credited to expense on your books, is eliminated as taxable income.

(j) Income received from A. D. Aitken, Trustee, is adjusted as shown in detail in Revenue Agent's report.

Mountain Producers Corporation

SCHEDULE 3.—CONSOLIDATED NET INCOME

Net income as corrected: Wyoming Associated Oil Corporation	$2,807,782.57
Net losses as corrected: Mountain Producers Corporation	23,281.10
Consolidated net income for tax purposes	$2,784,501.47

SCHEDULE 4.—COMPUTATION OF TAX

INCOME TAX

Net income for taxable year	$2,784,501.47
Income tax at 13%	361,985.19
Total tax assessable	361,985.19
Tax previously assessed	271,342.32
Additional tax to be assessed	$90,642.87

Exhibit B to petition

Tract	Sec.	T.	R.
W½ 12, N½ SW & NW	13	40	79
S½ SW	13		
S½ SE	14		
NW SE	14		
NE SW & S½ SW	14		
NW SW	14		
S½ NW	14		
NW NW	14		
NE NE & S½ NE	15		
NW NE	15		
E½ NE SE	15		
S½ SE less SE SE SE	22		
SE SE SE	22		
E½ NE	23		
NE SE & SE SE	23		
SE SW	23		
SW SW	23		
NE	24		
NE SE	24		
NW SE	24		
NE SW	24		
NW SW	24		
E½ NW	24		
W½ NW	24		
E½	25		
S½ SW	25		
SW NE	26		
NW NE	26		
SE SE	26		
SW SE	26		
S½ SW	26		
E½ NW	26		
SW NW	26		
NW NW	26		
NE NE	27		
NW NE	27		
S½ NE	34		
NE SE & N½ SW SE	34		
NW SE	34		
S½ NW	34		
NE SE & S½ SE	35		
NW SE	35		
NE NW & S½ NW	35		
NW NW	35		
All	36		
N½ SW NW	19	40	78
S½ SW NW	19		
SW SE	30		
NW SE	30		
NE SW & S½ SW	30		
NW SW	30		
S½ SW NW	30		
N½ SW NW	30		
NW NW	30		
S½ NW	1	39	79
NW NW	1		
NE NE & S½ NE	2		
NW NE	2		
SW NW	5	39	78
Sec.	6		

Exhibit C to petition

This Contract, made and entered into this 18th day of July 1919, by and between the Wyoming Associated Oil Corporation, a corporation of the State of Delaware hereafter called the Producing Company, Party of the First Part, and The Midwest Refining Company,

a corporation of the State of Maine, hereafter called the Refining Company, party of the Second Part, Witnesseth:

That Whereas, the Producing Company is in possession of and owns certain interests in oil lands situated in the Salt Creek Oil Fields, Natrona County, State of Wyoming, and is desirous of entering into an arrangement with the Refining Company for the sale to and purchase by the Refining Company of crude oil hereafter to be produced from said lands; and

Whereas, the Refining Company is the owner of certain
14 refining plants at Casper, Wyoming, and is engaged in the business of purchasing, transporting, refining and marketing crude oil and the products thereof; and

Whereas, the parties hereto mutually desire to effect an agreement establishing for a term of years their relations respecting the production, purchase and sale of crude oil upon the terms and conditions hereinafter set forth:

Now, Therefore, in consideration of the payment of One ($1.00) Dollar and other good and valuable considerations, receipt of which is hereby acknowledged, and mutual benefits derived and to be derived from the faithful performance of the terms and conditions hereinafter set forth, the parties hereto mutually covenant and agree as follows, to-wit:

First: That all said oil lands now in the possession of the Producing Company, or hereafter in the possession of the Producing Company, in said Salt Creek Oil Fields, (Natrona County, Wyoming) shall be and hereby are subjected to the terms and conditions of this agreement.

Second: The Refining Company shall, as from the first day of June 1919 to the first day of January 1934, produce from said lands of the Producing Company and purchase from that Company at least one-third (⅓) of the total amount of oil at any time then being produced or purchased by the Refining Company in or from said Salt Creek Oil Fields (Natrona County, Wyoming), subject, however, to a deduction from said one-third (⅓) of the same amount of oil as may be concurrently deducted from the aggregate deliveries of oil by The Midwest Oil Company to the Refining Company, but in no event shall such deduction exceed one-twelfth ($\frac{1}{12}$) of the total amount of oil at any time then being produced or purchased by the Refining Company in or from said Salt Creek Oil Fields (Natrona County, Wyoming); provided, that at no time shall there be any such deduction except for the purpose of enabling the Refining Company to buy independent crude oil.

The obligations of the Refining Company to take such fraction (one-third) of said oil from the lands of the Producing Company shall continue only so long as the lands of the Producing Company are capable of producing that amount of oil but whenever the Refining Company, either under its now existing contractual obliga-
15 tions or under future modifications or changes thereof, may legally produce from said oil lands of the Producing Company

and purchase from it such quantity of oil in excess of said one-third (⅓) as will make the ratio between the oil purchased from the Producing Company and the total amount of oil produced or purchased by the Refining Company in or from said Salt Creek field more nearly equal the ratio between the estimated oil content of the lands of said Producing Company and the total estimated oil content of such fields, the Refining Company hereby agrees to increase the amount so produced and purchased from time to time up to the full amount of said proportion, and in excess thereof if it so desires.

Third: The Refining Company shall be given and granted, and hereby is given and granted, for the period extending from the first day of June 1919 to and until the first day of January 1934, subject to the forfeiture clause hereinafter set forth, exclusive possession, right of occupation and enjoyment of said oil lands of the Producing Company for the purpose of producing oil therefrom and of purchasing all oil so produced; the Refining Company shall pay all the costs of sinking wells on said lands required to produce said oil, and all expenses of the production, the storage, and the transportation thereof, except that the Refining Company shall have the use of all storage facilities, pipe lines, tools, and machinery now in said fields and used in connection with the development, production, and storage of oil, and of all buildings in connection therewith, and shall have free of charge the oil and gas used in connection with drilling and domestic service on the lands of the Producing Company.

As to the gas produced over and above that used in drilling and domestic service as aforesaid, the Producing Company reserves the right of entry for the purpose of conserving and utilizing the gas and values thereof.

A deduction of three per centum (3%) for moisture and basic sludge shall be allowed upon crude oil.

Fourth: All taxes on all oil produced shall be borne one-half (½) by the Refining Company and one-half (½) by the Producing Company; all taxes on physical property shall be borne by the Refining Company.

Fifth: A—During the period from June 1st, 1919, to June 1st, 1922, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing shall be fixed and determined as follows:

When the average price received for gasoline at said Casper (Wyoming) refinery during any month is eighteen cents (18c) per gallon, and the average price received for Water White Kerosene Oil during said month is seven and one-half cents (7½c) per gallon, the crude oil taken under this contract for said month shall be settled for at the base price of one dollar thirty-two and one-half cents ($1.32½) per barrel. If the average price received by the Refining Company during any month for gasoline at its Casper (Wyoming) Plant, shall be

less or more than eighteen cents (18c) per gallon, then for each cent increase or decrease over or under said sum of eighteen cents (18c) there shall be added to or subtracted from said base price of one dollar thirty-two and one-half cents ($1.32½) five cents (5c) per barrel in order to compute the settlement price of crude oil for said month, and if the said average price received by the Refining Company at its said Casper Plant for Water White Kerosene Oil shall be less or more than seven and one-half cents (7½c) per gallon, then for each cent increase or decrease over or under said sum of seven and one-half cents (7½c) there shall be added to or subtracted from said base price of one dollar thirty-two and one-half cents ($1.32½) two and one-half cents (2½c) per barrel in order to compute the settlement price of crude oil for said month. Decreases or increases of less than one cent (1c) in the price of either Gasoline or Water White Kerosene oil shall be figured proportionately.

B—During the period from June 1st, 1922, to June 1st, 1925, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May 1922, the Producing Company shall notify the Refining Company in writing whether the Producing Company elects to accept for the period of three (3) years, beginning June 1, 1922, the price fixed as provided in sub-division A, Paragraph Five, hereof, or to accept for said period a price fixed as in
17 said sub-division A, Paragraph Five, but with a variation in price of crude oil of seven cents (7c) per barrel for each variation of one cent (1c) in the average price of gasoline per gallon, and a variation of three and one-half (3½c) per barrel for each variation of one cent (1c) in the average price of Water White Kerosene Oil per gallon, and the Refining Company shall pay for Crude Oil in accordance with such election.

C—During the period from June 1, 1925, to June 1, 1928, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May 1925, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in subdivision B of this paragraph Five, it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

D—During the period from June 1, 1928, to June 1, 1931, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May 1928, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in subdivision B of this Paragraph Five

it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

E—During the period from June 1, 1931, to January 1, 1934, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May 1931, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in subdivision B of this Paragraph Five it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

It is understood that in no event shall the price paid for Crude Oil hereunder be less than sufficient to enable the said
18 Producing Company to pay all the present existing royalties or charges upon oil produced in said lands.

Six: Payment for oil purchased by the Refining Company from the Producing Company shall be made to the Producing Company at the Producing Company's office on or before the twentieth day of the month succeeding the calendar month in which the oil is produced, provided one-third (⅓) of the total Salt Creek Oil taken into the Casper refinery during the said calendar month, except the so-called "independent oil," shall be paid for and variations between such amount and the actual production of the Producing Company shall be adjusted and settled for at the end of each year of the contract, or sooner if practicable.

Seven: If at any time during the term of this contract the Government, either State or National, shall exact a royalty on any oil taken from the lands of the Producing Company, the Refining Company will either purchase from such Government said royalty oil, or if the Producing Company has purchased said royalty oil the Refining Company will purchase it from the Producing Company at the price paid by the Producing Company for such royalty oil; provided, that the Refining Company shall be given the exclusive right to agree in behalf of the Producing Company with the Government as to the price to be paid for such oil.

Eight: The Refining Company at all times shall operate said lands of the Producing Company in all proper and reasonable ways for the protection and conservation of the oil and gas content thereof, and for the production of the maximum amount of Crude Oil purchasable by the Refining Company hereunder. In the event that the drilling, production, or conservation methods of the Refining Company shall not meet the approval of the Engineer who may be employed by the Directors on the Board of the Producing Company elected by Mary Dean Reed or her nominee, the said Engineer and the Engineer of the Refining Company shall select a third Engineer, and the decision of a majority of these three engineers on any point at issue shall prevail as to the future proceeding on such point. The

Refining Company shall be furnished by the Producing Company with copies of all leases, contracts, and written obligations pertaining to the operation of said lands, or any part thereof, and if in doubt as to the scope or meaning of such leases, contracts, or obliga-
19 tions shall on request be advised by Counsel of the Producing Company in respect thereto, and thereupon the Refining Company shall faithfully perform the terms of all such contracts and leases and sustain such obligations, except that the Refining Company shall not pay any royalties or charges which may be either now fixed upon said lands, or any part thereof, or may be hereafter arranged between said Producing Company, as owner and occupant of said lands or interest therein, and third parties for contracts affecting said lands, or as between the Producing Company as Lessee and its Lessors. From time to time the Producing Company shall notify the Refining Company in writing as to any and all assessment work that should be performed on or in respect to any lands of the Producing Company, and thereupon in due course the Refining Company will perform such assessment work and charge the cost thereof to the Producing Company.

Nine: This agreement shall extend to the titles to said lands of the Producing Company as at present held and as the titles may hereafter be perfected or altered in any way. The Refining Company shall always respect the titles to said lands and interests of the Producing Company and shall take no steps in any way prejudicial thereto; and on the other hand, of for any reason or from any cause whatever the titles of the Producing Company are changed to any form or leasehold, deed or contract differing from the present nature or status of its ownership as to all or any part of said lands, whether greater or less in extent of title or estate, this contract shall extend to such titles in their changed or altered form and such titles and alterations thereof shall be subject hereto; provided, however, that nothing herein conta. d shall be construed to limit the right of the Producing Company to adjust litigation or claims instituted or asserted by other persons affecting the property of the Producing Company, if any such litigation or claims there be, and the Refining Company shall release from the operation of this contract any lands covered hereby and necessary to be released in affecting such adjustment.

Ten: The Producing Company shall pay all expenses in connection with the maintenance and perfection of its own titles, including charges for assessment work.

Eleventh: The Producing Company may at all times main-
20 tain Gaugers and Inspectors upon said lands and shall be furnished by the Refining Company with monthly statements showing:

(a)—The total amount of oil produced from the lands of the Producing Company..

(b)—The entire amount of oil being produced from the Salt Creek Oil Field (Wyoming), itemized as to the respective parcels of land from which said oil has been produced, so far as such information is *reasonable* accessible to the Refining Company.

(c)—The number of barrels of gasoline and Water White Kerosene Oil, respectively, sold by the Refining Company, and the gross price received for each product.

Twelve: Performance shall be excused by acts of God, public enemies, strikes, fires, elemental disturbances, failure of oil supply, unavoidable accidents or causes beyond reasonable control, but, subject to these causes only, if the Refining Company fails to comply with any of the conditions and sustain all obligations imposed upon it hereby and such failure continues for a period of sixty (60) days after notice in writing to the Refining Company from the Producing Company, then the Producing Company may at once declare this contract forfeited and terminated, and without process of law may re-enter upon said premises as of its first and former estate; or, at the option of the Producing Company it may require the Refining Company to continue the operation, insisting upon full compliance by the Refining Company, and any acceptance by the Producing Company of performance less favorable than that to which it is entitled will constitute in no way a waiver of its full rights under the contract.

Thirteen: On the first day of January 1934 possession of all the lands of the Producing Company shall be returned to it by the Refining Company.

Fourteen: This contract shall inure to and be binding upon the successors and assigns of the respective parties hereto.

In Witness Whereof, the parties have caused their respective corporate names to be hereunto signed and their corporate seals to be affixed by their proper officers, thereunto duly authorized, in duplicate, at Denver, Colorado, on the day and year first above written.

WYOMING ASSOCIATED OIL CORPORATION.
By N. S. WILSON, *President.*

Attest:

J. L. WARREN, *Secretary.*

THE MIDWEST REFINING COMPANY,
By T. A. DINES, *Vice President.*

Attest:

C. E. TITUS.

Exhibit D to petition

	Gross less Government royalties	Royalties paid direct	Royalties paid by company	Company net
	Barrels	*Barrels*	*Barrels*	*Barrels*
W½ 12, N½ SW & NW 13-40-79	256, 993. 32	28, 699. 38	6, 360. 61	224, 933. 33
S½ SW 13	63, 037. 63		12, 338. 83	50, 698. 80
S½ SE 14	118, 891. 40	2, 849. 51	3, 839. 72	135, 786. 12
NW SE 14 14	23, 583. 80			
NE SW & S½ SW 14	88, 749. 90	3, 141. 49	2, 793. 33	98, 781. 70
NW SW 14	15, 966. 62			
S½ NW 14	87, 385. 99	5, 729. 58	3, 343. 86	118, 250. 94
NW NW 14	39, 938. 39			
NE NE & S½ NE 15	87, 246. 19		2, 893. 46	102, 323. 24
NE NE 15	17, 970. 51			
E½ NE SE 15	14, 744. 63		405. 47	14, 339. 16
S½ SE less SE SE SE 22	66, 403. 94		1, 937. 20	68, 506. 49
SE SE SE 22	4, 039. 75			
E½ NE 23	100, 803. 92	7, 056. 28	2, 578. 05	91, 169. 59
NE SE & SW SE 23	141, 915. 55	1, 419. 14	3, 863. 64	136, 632. 77
SE SW 23	46, 639. 80	932. 81	8, 203. 95	37, 503. 14
SW SW 23	8, 279. 12	167. 59	225. 80	7, 985. 73
NE 24	277, 653. 55	4, 858. 94	7, 501. 86	265, 292. 75
NE SE 24	50, 900. 62	6, 529. 10	5, 790. 47	205, 316. 57
NW SE 24	166, 735. 52			
NE SW 24	27, 864. 10	1, 463. 61	1, 033. 06	36, 533. 10
NW SW 24	11, 165. 67			
E½ NW 24	103, 167. 59	16, 952. 65	6, 992. 96	247, 296. 24
W½ NW 24	168, 074. 26			
E½ 25	400, 937. 36		59, 764. 76	341, 172. 60
S½ SW 25	55, 147. 72	1, 102. 96	1, 486. 24	52, 558. 52
SW NE 26	32, 847. 52	2, 824. 08	19, 828. 55	71, 483. 47
NW NE 26	61, 288. 58			
SE SE 26	47, 870. 71	1, 426. 12	10, 070. 44	36, 364. 15
SW SE 26	102, 543. 16	3, 076. 31	12, 125. 76	87, 341. 09
S½ SW 26	34, 181. 42		3, 990. 88	30, 190. 54
E½ NW 26	226, 719. 68		6, 234. 80	220, 484. 88
SW NW 26	77, 401. 89		24, 085. 59	173, 091. 36
NW NW 26	119, 775. 06			
NE NE 27	34, 323. 06	6, 019. 60	2, 593. 47	91, 713. 95
NW NE 27	66, 003. 96			
S½ NE 34	78, 572. 90		7, 827. 89	70, 745. 01
E SE & N½ SW SE 34	63, 455. 03		2, 961. 64	104, 735. 02
NW SE 34	44, 241. 63			
S½ NW 34	17, 942. 72		493. 42	17, 449. 30
NE SE & S½ SE 35	171, 889. 73		7, 071. 11	250, 060. 14
NW SE 35	85, 241. 52			
22 NE NW & S½ NW 35	401, 817. 88		107, 387. 34	343, 528. 52
NW NW 35	49, 097. 98			
All 36	177, 177. 72		4, 872. 39	172, 305. 33
N½ SW NW 19-40-78	44, 553. 01	779. 68	1, 053. 68	42, 719. 65
S½ SW NW 19	32, 202. 61	718. 40	727. 52	30, 756. 69
SW SE 30	50, 086. 48	876. 54	1, 184. 54	48, 025. 40
NW SE 30	93, 342. 31	2, 068. 07	2, 109. 18	89, 065. 06
NE SW & S½ SW 30	135, 843. 79	2, 377. 32	3, 212. 71	130, 253. 76
NW SW 30	69, 692. 80	1, 573. 21	1, 570. 46	66, 549. 13
S½ SW NW 30	19, 692. 02	344. 62	465. 71	18, 881. 69
N½ SW NW 30	24, 956. 74	3, 085. 98	3, 009. 57	128, 030. 94
NW NW 30	109, 169. 75			
S½ NW 1-39-79	101, 671. 48	23, 530. 19	9, 812. 53	89, 153. 22
NW NW 1	20, 824. 46			
NE NE & S½ NE 2	178, 576. 03		21, 158. 52	229, 964. 08
NW NE 2	72, 546. 57			
SW NW 5-39-78	2, 870. 37			2, 870. 37
Sec. 6	31, 874. 95			31, 874. 95
	5, 324, 532. 62	126, 613. 16	385, 200. 97	4, 812, 718 49

Exhibit E to petition

Tract		*50% Net Income*
W½ 12, NW and N½ SW	13–40–79	$108,819.18
S½ SW	13	22,709.86
S½ SE and NW SE	14	65,689.20
SW	14	46,167.86
S½ NW and NW NW	14	55,499.04
NE	15	47,757.92
E½ NE SE	15	6,481.68
S½ SE	22	30,860.21
E½ NE	23	43,026.95
NE SE and SW SE	23	65,424.13
SE SW	23	17,636.90
SW SW	23	3,575.18
NE	24	121,797.28
N½ SE	24	100,145.79
N½ SW	24	16,385.91
NW	24	112,899.12
E½	25	155,757.41
S½ SW	25	23,993.59
W½ NE	26	36,755.73
SE SE	26	23,440.41
SW SE	26	40,547.88
S½ SW	26	15,551.54
E½ NW	26	101,890.20
W½ NW	26	87,434.01
23 N½ NE	27	41,447.76
S½ NE	34	33,807.57
N½ SE and N½ SW SE	34	47,707.01
S½ NW	34	7,992.94
SE	35	113,916.43
NW	35	171,788.84
All of Sec.	36	70,842.65
N½ SW NW	19–40–78	21,951.77
S½ SW NW	19	16,930.40
SW NE	30	26,561.52
NW SE	30	49,339.05
NE SW and S½ SW	30	69,713.91
NW SW	30	36,245.28
S½ SW NW	30	10,048.89
NW NW and N½ SW SW	30	70,797.59
S½ NW and NW NW	1–39–79	44,091.78
NE	2	113,841.43
SW NW	5–39–78	—3,592.59
600 acres in Sec.	6	3,031.93
		2,296,711.14

Tract	Reserves 1-1-25	Cost 1-1-25	Cost added 1925	Unit cost	3-1-13 Appreciation	Unit appreciation	Production 1925	Depletion cost	Depletion appreciation
W½ 12, NW and N½ SW 13-40-79	1,101,428.04	364,977.14		0.33137	39,191.75	0.03558	224,933.33	74,536.16	8,003.13
S½ SW 13	389,804.22	6,545.27		0.01679	451.75	0.00116	50,098.80	851.23	58.81
S½ SE and NW SE 14	1,245,492.34	379,477.66		0.30468	50,766.00	0.04076	135,786.12	41,371.32	5,534.64
SW 14	773,149.23	471,319.20		0.60961	66,716.24	0.08629	98,781.70	60,218.31	8,523.87
S½ NW and NW NW 14	623,360.71	246,897.58		0.39607	36,547.15	0.05863	118,250.94	46,935.65	6,933.05
NE 15	649,578.47	93,008.73		0.14318	6,998.51	0.01077	102,323.24	14,650.64	1,102.02
E½ NE SE 15	47,052.89	11,064.32		0.23515	1,415.87	0.03009	14,339.16	3,371.85	431.47
S½ SE 22	261,083.59	218,131.63		0.83549	34,169.95	0.13088	68,506.49	57,236.49	8,966.13
E½ NE 23	591,639.46	265,757.68		0.44919	28,305.61	0.04784	91,169.59	40,952.47	4,361.55
NE SE and SW SE 23	1,315,504.08	345,822.70	4,687.50	0.26645	36,761.05	0.02794	136,632.77	36,405.80	3,817.52
SE SW 23	420,758.41	161,533.63		0.38391	21,458.67	0.05100	37,503.14	14,397.83	1,912.66
SW SW 23	278,142.15	128,220.76		0.46099	13,635.41	0.04902	7,985.73	3,681.34	391.46
NE 24	1,362,449.37	126,887.95	9,375.00	0.10001	9,021.05	0.00662	265,292.75	26,531.93	1,756.24
N½ SE 24	909,993.30	171,417.50	4,687.50	0.19352	16,522.48	0.01816	205,316.57	39,732.86	3,728.55
N½ SW 24	700,147.67	314,975.78		0.44987	38,938.90	0.05562	36,533.10	16,444.14	2,033.08
NW 24	1,368,621.79	551,453.26		0.40293	65,025.25	0.04751	247,296.24	99,643.07	11,749.04
E½ 25	1,932,023.65	227,801.28		0.11791	24,736.89	8.01280	341,172.60	40,227.66	4,367.01
S½ SW 25	746,672.04	374,412.19		0.50144	52,947.25	0.07091	52,558.52	26,354.94	3,726.92
W½ NE 26	1,845,787.72	295,133.99		0.15990	33,300.10	0.01804	71,483.47	11,430.21	1,289.56
SE SE 26	503,095.99	107,560.29		0.21380	13,325.73	0.02649	36,364.15	7,774.66	963.29
SW SE 26	1,206,001.61	97,253.47		0.08064	11,635.88	0.00965	87,341.09	7,043.19	842.84
S½ SW 26	1,918,301.61	242,263.44		0.12629	−6,219.16	0.00324	30,190.54	3,812.76	−97.82
E½ NW 26	2,015,046.96	397,682.09		0.19736	42,442.92	0.02106	220,484.88	43,514.90	4,643.41
W½ NW 26	1,091,619.06	368,808.34		0.33785	45,274.09	0.04147	173,091.36	58,478.92	6,178.10
N½ NE 27	424,707.26	174,674.71		0.41128	23,429.83	0.05517	91,713.95	37,720.11	5,059.86
S½ NE 34	940,657.62	261,835.07		0.27852	38,831.21	0.04128	70,745.01	19,703.90	2,920.35
N½ SE and N½ SW SE 34	733,232.21	255,980.24		0.34911	35,544.78	0.04848	104,735.02	36,564.04	5,077.55
S½ NW 34	63,580.98	41,229.50		0.64846	2,248.39	0.03536	17,449.30	11,315.17	617.01
SE 35	1,976,992.66	674,338.28		0.34109	89,139.52	0.04509	250,060.14	85,293.01	11,275.21
NW 35	3,942,033.87	542,841.29		0.13771	65,954.84	0.01673	343,528.52	47,307.31	5,747.23
All of Sec. 36	789,696.67	174,745.66		0.22128	23,759.82	0.03009	172,305.33	38,127.72	5,184.67
N½ SW NW 19-40-78	250,981.54	12,943.05		0.05157	236.74	0.00094	42,719.65	2,203.05	40.16
S½ SW NW 19	199,578.90	43,043.15		0.21567	3,441.71	0.01724	30,756.69	6,633.30	530.25
SW SE 30	207,859.60	24,074.85		0.11582			48,025.40	5,562.30	
NW SE 30	443,181.49	74,781.83		0.16874	5,831.64	0.01316	89,065.06	15,028.84	1,172.10
NE SW and S½ SW 30	979,837.96	102,717.13		0.10483	2,512.78	0.00256	130,253.76	13,654.50	333.45
NW SW 30	495,508.34	73,754.72		0.14885	5,707.79	0.01152	66,649.13	9,905.84	766.65
S½ SW NW 30	330,188.74	18,252.17		0.05528	408.83	0.00124	18,881.69	1,043.78	23.41
NW NW and N½ SW NW 30	931,702.36	131,603.79		0.14125	10,187.55	0.01093	128,030.94	18,084.37	1,399.38
S½ NW and N NW 1-39-79	484,837.30	101,576.23		0.20951	10,831.26	0.02234	89,153.22	18,678.49	1,991.68
NE 2	1,014,100.24	311,403.39		0.30707	42,598.82	0.04201	229,964.08	70,615.07	9,660.79
SW NW 5-39-78	7,972.99	931.33		0.11681			2,870.37	335.29	
600 acres in Sec. 6	84,869.04	19,188.90		0.22610	405.18	0.00477	31,874.95	7,206.93	152.04
	37,598,274.13	9,008,322.17	18,750.00		1,044,440.03		4,812,718.49	1,220,481.35	144,168.32

Tract Sec. T R	Gross value of oil	Royalties paid direct	Royalties paid by company	Gross income from oil	Gross income from gas	Total gross income
W½ 12, N½ SW & NW 13-40-79	444, 360. 05	44, 997. 94	6, 422. 43	192, 939. 68	16, 893. 97	409, 833. 65
S½ SW 13	116, 701. 45		11, 420. 61	105, 280. 64	1, 226. 86	106, 507. 50
S½ SE 14						
NW SE 14	255, 724. 60	5, 146. 69	3, 694. 34	246, 683. 77	8, 875. 04	255, 558. 81
NE SW & S½ SW 14						
NW SW 14	180, 932. 67	5, 493. 00	2, 835. 36	172, 604. 31	2, 981. 02	175, 585. 33
S½ NW 14						
NW NW 14	220, 578. 33	10, 031. 26	3, 333. 30	207, 213. 77	6, 438. 52	213, 652. 29
NE NE & S½ NE 15						
NW NE 15	189, 637. 81		2, 912. 14	186, 725. 67	3, 880. 47	190, 606. 14
E½ NE SE 15						
S½ SE less SE SE SE 22	24, 958. 59		408. 52	24, 550. 07	51. 32	24, 601. 39
SE SE SE 22	125, 225. 64		1, 958. 16	123, 267. 48		123, 267. 48
E½ NE 23						
NE SE & SW SE 23	175, 678. 75	12, 455. 13	2, 587. 84	160, 635. 78	5, 025. 14	165, 660. 92
SE SW 23	242, 311. 34	2, 465. 52	6, 159. 21	233, 686. 61	9, 630. 88	243, 317. 49
SW SW 23	84, 067. 88	1, 692. 94	7, 802. 94	74, 572. 00	918. 30	75, 490. 30
NE 24	14, 663. 44	298. 07	227. 20	14, 138. 17		14, 138. 17
NE SE 24	531, 422. 51	9, 333. 45	7, 585. 24	514, 503. 82	6, 178. 46	520, 682. 28
NW SE 24						
NE SW 24	382, 883. 56	11, 679. 40	5, 891. 48	365, 312. 68	14, 330. 34	379, 643. 02
NW SW 24						
E½ NW 24	69, 853. 43	2, 624. 11	1, 040. 35	66, 218. 97	1, 230. 87	67, 449. 84
W½ NW 24						
E½ 25	487, 620. 96	30, 831. 62	7, 054. 76	449, 734. 56	5, 030. 96	454, 765. 52
S½ SW 25	724, 525. 85		90, 070. 22	634, 455. 63	6, 910. 63	641, 366. 26
SW NE 26	97, 175. 21	1, 963. 99	1, 480. 09	93, 731. 13	1, 506. 08	95, 237. 21
NW NE 26	168, 534. 74	5, 136. 71	13, 466. 13	149, 931. 90	294. 94	150, 226. 84
SE SE 26	82, 212. 96	2, 493. 15	5, 731. 38	72, 988. 43	10, 904. 90	83, 893. 33
SW SE 26	186, 001. 42	5, 611. 67	8, 571. 83	171, 817. 92		171, 817. 92
S½ SW 26	57, 853. 23		2, 813. 57	55, 039. 66	2, 738. 47	57, 778. 13
E½ NW 26	406, 466. 93		6, 293. 91	399, 173. 02	5, 525. 03	404, 698. 05
SW NW 26						
NW NW 26	341, 172. 39		16, 929. 25	324, 243. 14	8, 340. 54	332, 583. 68
NE NE 27						
NW NE 27	178, 071. 72	10, 811. 36	2, 641. 64	164, 618. 72		164, 618. 72
S½ NE 34	143, 303. 47		4, 939. 05	138, 364. 42	1, 251. 00	139, 615. 42
NE SE & N½ SW SE 34						
NW SE 34	184, 950. 12		2, 986. 60	181, 963. 52	1, 039. 28	183, 002. 80
S½ NW 34	31, 184. 66		499. 48	30, 685. 18	214. 97	30, 900. 15
NE SE & S½ SE 35						
NW SE 35	470, 592. 57		7, 122. 87	463, 469. 70	3, 917. 21	467, 386. 91

Exhibit G to petition—Continued

Tract	Sec.	T	R	Gross value of oil	Royalties paid direct	Royalties paid by company	Gross income from oil	Gross income from gas	Total gross income
NE NW & S½ NW	35			713,010.84		87,661.21	625,349.63	16,290.58	641,640.21
NW NW	35								
All	36			896,414.17		5,646.52	890,767.65	6,507.06	897,364.71
N½ SW NW	19	40	78	81,180.47	1,434.31	1,070.43	78,675.73	651.64	79,327.37
S½ SW NW	19			61,277.57	1,382.86	756.23	59,138.46	808.45	59,946.91
SW SE	30			95,268.85	1,692.22	1,239.25	92,337.38	2,744.75	95,082.13
NW SE	30			175,532.41	3,942.94	2,184.18	169,405.29	3,559.57	172,964.86
NE SW & S½ SW	30			256,286.85	4,525.13	3,307.66	248,454.06	5,145.28	253,599.34
NW SW	30			130,345.28	2,974.42	1,621.37	125,749.49	1,576.04	127,325.53
S½ SW NW	30			35,532.48	626.43	473.07	34,432.98	1,024.92	35,457.90
N½ SW NW	30			262,413.03	6,099.25	3,107.66	253,206.12	3,257.37	256,463.49
NW NW	30								
S½ NW	1	39	79	218,150.88	36,331.84	6,239.92	175,579.12	2,935.42	178,514.54
NW NW	1								
NE NE & S½ NE	2			468,083.91		13,910.16	454,173.75	10,382.51	464,556.26
NW NE	2								
SW NW	5	39	78	5,017.50			5,017.50	909.70	5,927.20
Sec.	6			54,478.59			54,478.59	3,151.49	57,630.08
				10,070,659.31	222,075.41	363,267.80	9,485,316.10	184,369.98	9,669,686.03

27 Before United States Board of Tax Appeals

Answer

Filed June 29, 1929

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph I of the petition.

(2) Admits the allegations contained in paragraph II of the petition.

(3) Admits the allegations contained in paragraph III of the petition.

(4) Denies the respondent erred in the determination of the deficiency as alleged in paragraph IV (a) of the petition.

(5) Admits the allegations contained in subparagraphs (a) to (f), inclusive, of paragraph V of the petition, denies the allegations contained in subparagraphs (g) to (n), inclusive, of paragraph V of the petition.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel: Maxwell E. McDowell, Frank B. Schlosser, Special Attorneys, Bureau of Internal Revenue.

Before United States Board of Tax Appeals

Amended petition

Filed Nov. 29, 1933

The above-named petitioner, by leave of the Board first obtained, hereby makes this its amended petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated March 14, 1929, and as a basis of its proceeding alleges as follows:

I. Petitioner is a Delaware Corporation, with its principal office at 607 First National Bank Building, Denver, Colorado.

28 II. The notice of deficiency, a true copy of which is attached hereto and marked "Exhibit A," was mailed to the taxpayer on March 14, 1929. The taxes in controversy are income taxes for the calendar year 1925 and are for $90,642.87, the total amount of the deficiency being in controversy and the taxpayer being

entitled to a refund of tax already paid by it and its affiliate, The Wyoming Associated Oil Corporation.

ASSIGNMENT OF ERRORS

III. The determination of tax set forth in said notice of deficiency is based on the following errors:

A. The decrease in the amount of depletion deduction of the Wyoming Associated Oil Corporation from $2,215,862.23 (which does not include depletion on Wyoming School lease Section 36, such depletion being omitted from the return) to $1,674,677.92 (which includes depletion on Section 36, shown in Exhibit B attached hereto), this reduction of depletion being based upon an incorrect interpretation and application of Section 204 (c) (2) of the Revenue Act of 1926 in that the depletion computed in the deficiency letter has been based upon 27½% of an incorrectly computed gross income, the true gross income of the Wyoming Associated Oil Corporation from the properties being substantially in excess of the amount calculated by the Commissioner of Internal Revenue and used as a basis for depletion.

B. The increase of the net taxable income of the Wyoming Associated Oil Corporation by the restoration thereto of $185,438.83, so-called income from state lands, whereas all proceeds from state lands leased by the taxpayer are exempt from tax under the decision of the United States Supreme Court in Burnett v. Coronado Oil & Gas Company, 285 U. S. 393.

C. The failure to allow as a deduction in computing the net income of Wyoming Associated Oil Corporation and the consolidated net income of it and the petitioner depletion based upon the cost of its depletable properties to Wyoming Associated Oil Corporation and/or the basis for depletion in the hands of the respective transferrors of said properties to Wyoming Associated Oil Corporation, including the costs to said transferrors, the value at the date of gifts or transfers in trust to said transferrors before December 31, 1920, and
29 the value at the date of death of properties acquired by said transferrors by request, devise, or inheritance.

STATEMENT OF FACTS

IV. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(1) The Mountain Producers Corporation was organized on May 12, 1920, under the laws of the State of Delaware, and was at all times hereinafter mentioned a Delaware corporation with its principal office at 607 First National Bank Building, Denver, Colorado.

(2) The Wyoming Associated Oil Corporation was organized on July 17, 1919, under the laws of the State of Delaware, and was, at all times hereinafter mentioned, a Delaware corporation, with its principal office at 607 First National Bank Building, Denver, Colorado.

(3) During and throughout the year 1925 the petitioner owned and held all the capital stock of Wyoming Associated Oil Corporation and was throughout said year affiliated in a Class A relationship with the Wyoming Associated Oil Corporation within the purview of Section 240 of the Revenue Act of 1926.

(4) The petitioner and the Wyoming Associated Oil Corporation filed for the year 1925 affiliated income tax returns on form 1120 and the deficiency letter of March 14, 1929, Exhibit A hereto attached, treats said corporations upon a consolidated basis.

(5) Prior to 1911 one William M. Fitzhugh, Mary Fitzhugh (his wife), William G. Henshaw, and certain other individuals, comprising a partnership or joint adventure, owned and held (a) certain titles, placer mining claims, and interests relating to located lands (sometimes referred to hereinafter as "the located lands"), (b) certain interests in a lease agreement relating to patented lands (sometimes referred to hereinafter as the "Stock Oil Company agreement"), and (c) a lease from the State of Wyoming of and to Section 36-40-79 (sometimes referred to hereinafter as the "school section land") in the Salt Creek Field, Natrona County, Wyoming, all of said claims, interests, and leases being sometimes referred to herein as "properties." The interests of the said individuals were undivided; said Fitzhugh and his wife owned ⅜ and Mr. Henshaw and his associates owned ⅝. A map showing the lands referred to above is attached hereto and is marked Exhibit C.

(6) On or about June 3, 1911, said William M. Fitzhugh and his wife sold and transferred to The Midwest Oil Company their undivided interest in and to said properties mentioned in paragraph (5).

(7) During the same year, and within a few months thereafter, said William G. Henshaw and his associates sold and transferred their undivided interest in said properties to The Reed Investment Company, acting as agent or trustee, as alleged in paragraph (10) hereof.

(8) On or about July 14, 1911, The Midwest Oil Company and The Reed Investment Company agreed to a partition and division of said properties mentioned in paragraph (5), including said school section land, wherein and whereby a specified 37½% of the school section land; a specified 37½% of said Stock Oil Company lease, and the NW¼ of each quarter section of located lands were to be turned over to The Midwest Oil Company and the remaining acreage was to be turned over to The Reed Investment Company. The said properties were divided and partitioned in accordance with said agreement.

(9) At about the same time The Reed Investment Company acquired through other sources an undivided one-half interest in a lease covering 80 acres of patented land in the Salt Creek Field, commonly known as the "Iba 80," being the S½ of the SW¼ of Section 13-40-79. A map showing the division of the above prop-

erties is attached hereto and marked Exhibit D. This map also reflects the loss of certain tracts to both parties resulting from settlements of title defect controversies, some of which settlements were of later date than July 14, 1911.

(10) In the transactions described in the foregoing paragraphs, The Reed Investment Company was acting, not for itself, but as agent or trustee for two groups of individuals, referred to hereinafter as the Majority and Minority Groups. The Majority Group consisted of the late Verner Z. Reed, and the Minority Group consisted of O. H. Shoup, B. H. Hopkins, K. C. Schuyler, and other individuals. The Majority Group owned an interest of 64.125% and the Minority Group, an interest of 35.875%.

31 (11) Pursuant to the rights and demands of the principals or beneficiaries for whom it was acting, The Reed Investment Company duly instructed and authorized that the legal title to all of said properties be conveyed, and the same was conveyed, to a group of corporations, to-wit:

The Control Oil Company,
The Crescent Oil Company,
The Seattle Oil Company,
The Bluestone Oil Company,
The California Oil Company,
The Henshaw Oil Company,
The Fitzhugh Oil Company,
The Pinero Oil Company,
The Barbadoes Oil Company, and
The Castle Creek Oil Company.

This transfer to said corporations was absolute in form, but was subject to the reservation that the ownership of the oil contained in the lands conveyed should remain in individuals who were the stockholders of said corporations, this ownership of said oil content being confirmed by a formal declaration of trust executed by each of the corporate grantees. The outstanding stock of said corporations was owned and held by the members of the Majority and Minority Groups in proportion to their respective interests in said groups.

(12) The said Verner Z. Reed on February 2, 1914, disposed of a 5% interest of his 64.125% interest in the said properties and transferred the same to The Equitable Trust Company of New York, as trustee for his daughter, Margery V. Reed.

(13) The said Verner Z. Reed, on February 2, 1914, disposed of a 5% interest of his 64.125% interest in the said properties and transferred the same to The Equitable Trust Company of New York, as trustee of his son, Verner Z. Reed, Jr.

(14) The said Verner Z. Reed, on February 2, 1914, disposed of a 5% interest of his 64.125% interest in the said properties and transferred the same to The Equitable Trust Company of New York, as trustee for his son, J. V. Reed.

32 (15) On or about April 3, 1914, said Verner Z. Reed gave absolutely, and transferred pursuant to said gift, to his wife, Mary Dean Reed, a 5% interest of his 64.125% interest in said properties.

(16) On July 10, 1916, said Verner Z. Reed disposed of a 9% interest of his 64.125% interest in said properties and transferred the same to The Equitable Trust Company as trustee of Trust No. 1.

(17) On July 10, 1916, said Verner Z. Reed disposed of a 9% interest of his 64.125% interest in said properties and transferred the same to The Equitable Trust Company as trustee of Trust No. 2.

(18) Said Verner Z. Reed died on or about April 20, 1919. At the time of his death he still owned 26.125% remaining out of said 64.125% interest. Said 26.125% interest passed to the executors under his will.

(19) On or about October 3, 1917, the members of said Minority Group transferred their several interests in said lands, aggregating 35.875%, to the Midwest Refining Company, and received in exchange therefor in proportion to their respective interests as members of the group, 11,402 shares of stock of The Midwest Refining Company.

(20) Subsequently, and in the month of January 1919, The Midwest Refining Company transferred to Salt Creek Producers Association, Inc., the properties so acquired as aforesaid from the Minority Group, together with certain other properties, including certain Curtis, Townsend, and Lobell, and other adverse or conflicting titles to the same properties in the Salt Creek Field, and received in exchange therefor 372,633 shares of stock of said Salt Creek Producers Association, Inc. At the time of this exchange the stock of the Salt Creek Producers Association, Inc., had a fair market value of not less than $25 per share.

(21) The exchange described in paragraph (20) has been recognized by the Commissioner as a taxable transaction, and The Midwest Refining Company has been charged with and has paid income and profits tax on and with respect to said transaction.

33 (22) At the time of the organization of the Wyoming Associated Oil Corporation in July 1919, the Salt Creek Producers Association, the members of the Majority Group, and their successors in interest, by reason of said trusts, gift, and death of Verner Z. Reed, and the several corporations enumerated in paragraph (12) to (20) inclusive hereof, transferred to the Wyoming Associated Oil Corporation all their right, title, and interest in and to all of said properties acquired from William G. Henshaw as alleged in paragraph (7) hereof, together with the properties referred to in paragraph (9), and the said Salt Creek Producers Association also transferred to said Wyoming Associated Oil Corporation all its right, title, and interest in and of said conflicting or adverse titles referred to in paragraph (20) hereof and commonly known as the Curtis, Townsend, and Lobell titles, and all the stock of certain corporations in which said adverse and conflicting titles were deposited,

receiving in exchange (a) for the said properties formerly owned by the Majority and Minority Groups 300,000 shares of stock of the Wyoming Associated Oil Corporation and (b) for the said conflicting or adverse titles, and the stock of the corporations in which the same had been deposited, 50,000 shares of said stock. The said stock of the Wyoming Associated Oil Corporation had no par value. A list of the various properties transferred to the Wyoming Associated Oil Corporation, referred to above, is attached hereto and marked Exhibit E–1. Attached hereto as Exhibit E–2 is a map showing said properties.

(23) The exchange described in paragraph (22), to the extent that the said adverse or conflicting titles were transferred for 50,000 shares of stock of the Wyoming Associated Oil Corporation, has been recognized by the Commissioner as a taxable transaction, and the Salt Creek Producers Association, Inc., has paid income and profits tax on and with respect to said transaction.

(24) In the years 1920 and 1921, Government leases were obtained by the Wyoming Associated Oil Corporation in exchange for and in lieu of the placer mining claims on located lands acquired by the corporation at the time of its organization.

(25) On or about February 1, 1923, Wyoming Associated Oil Corporation, The Midwest Oil Company, and the Wyoming
34 Oil Fields Company, entered into a contract wherein and whereby the said companies exchanged with and among each other certain interests in property and leases in the Salt Creek field for other interests in property and leases owned by them respectively. A list of the interests and leases owned by the Wyoming Associated Oil Corporation before said exchange is attached hereto and marked Exhibit F–1. Attached hereto as Exhibit F–2 is a map showing said properties.

A list of the interests and leases owned by the Wyoming Associated Oil Corporation after said exchange is attached hereto and marked Exhibit G–1. Attached hereto as Exhibit G–2 is a map showing said properties.

The interests and leases appearing on the first of said lists and not on the second were surrendered on the exchange, and the interests and leases appearing on the second of said lists and not on the first were received on the exchange. The interests and leases on both lists were not involved in the exchange.

(26) In the years 1919 to 1924, inclusive, various properties in the Salt Creek field were purchased and acquired by the Wyoming Associated Oil Corporation as listed in Exhibit H–1 attached hereto and shown on the map attached hereto as Exhibit H–2.

Other properties were sold and disposed of as listed in Exhibit I–1 attached hereto, and shown on the map attached hereto as Exhibit I–2.

The result of said transactions was that at the beginning of 1925 Wyoming Associated Oil Corporation owned and was entitled to depletion for that year with respect to the properties and leases listed

in Exhibit N–1 attached hereto and shown on the map attached hereto as Exhibit N–2.

Said properties included a 50% undivided interest in said lease from the State of Wyoming covering said Section 36, a state school section.

(27) On or about February 1, 1923, the Wyoming Associated Oil Corporation, The Midwest Oil Company, and the Wyoming Oil Fields Company as producing oil companies, entered into a contract with The Midwest Refining Company wherein and whereby for the consideration stated in said contract The Midwest Refining Company agreed to purchase the oil from and on behalf of Wyoming Associated Oil Corporation, to perform certain acts respecting certain of said properties, including said school section 36, for a period ending at noon on the first day of January 1934, a true copy of said contract being annexed hereto as Exhibit J and made a part hereof for all intents and purposes. On said same date of February 1, 1923, Wyoming Associated Oil Corporation and The Midwest Refining Company entered into a similar contract relating to the other properties of Wyoming Associated Oil Corporation. A true copy of said contract is annexed hereto as Exhibit K and made a part hereof.

(28) The lease agreement in effect during the calendar year 1925 wherein and whereby the State of Wyoming leased to the Wyoming Associated Oil Corporation its said part of Section 36 in said Salt Creek field is dated April 19, 1923, and runs for the period commencing October 1, 1924, and ending September 30, 1929. A copy of said lease is attached hereto as Exhibit L.

(29) On or about February 1, 1923, The Midwest Oil Company executed in favor of the Wyoming Associated Oil Corporation a declaration of trust with respect to the then outstanding lease in Section 36 in the State of Wyoming. Said declaration of trust applies to all renewals thereof, and said lease, Exhibit L, is and was a renewal of the preceding lease in effect when said declaration of trust was executed. A copy of said declaration of trust is attached hereto as Exhibit M.

(30) In the taxable year 1925 the Wyoming Associated Oil Corporation realized substantial proceeds from the operation of its interest in Section 36. The sum of $185,438.83 has been restored to consolidated taxable net income in the deficiency letter, Exhibit A.

(31) The total depletion allowed by the Commissioner of Internal Revenue in the deficiency letter, Exhibit A hereto attached, and including depletion with respect to Section 36, is $1,674,677.92. Of said total depletion allowed, the Commissioner allowed $45,927.12 of depletion referable to said State School land (Section 36).

(32) The gross income from the properties of the Wyoming Associated Oil Corporation listed in Exhibit N–1 for the year 1925 and the net income of the Wyoming Associated Oil Corporation from said properties was as set forth in this Exhibit. Said Exhibit

36 N-1 shows also (a) 27½% of the gross income from said properties during the taxable year; (b) 50% of the net income of the taxpayers from said properties for the taxable year computed without allowance for depletion; and (c) percentage depletion (without reference to costs or other depletion properly allowable under the statute), consisting of 27½% of said gross income, limited to 50% of said net income. Said gross income is computed in the following manner:

The beginning point in the computation is the total amount received during the year by the Wyoming Associated Oil Corporation, pursuant to the contracts with The Midwest Refining Company dated February 1, 1923, referred to in paragraph (27) hereof. To this sum is added, in respect to each tract, the following: (a) well expense, (b) development expense, and (c) a pro rata share of the overhead expense. Well expense includes all the lifting cost, labor, teaming and freight, supplies and other intangible costs, and materials and labor consumed. Development expense includes the intangible cost of drilling wells, including labor, teaming and trucking and incidental expenses, but does not include any charges for depreciation on equipment or camp buildings. Overhead expense includes field overhead, general administration expense, real estate and personal property taxes, production taxes, miscellaneous state and federal taxes and salaries, prorated to the properties of the Wyoming Associated Oil Corporation. Well expense, development expense and overhead expense for all the properties of the Wyoming Associated Oil Corporation are allocated to the several tracts upon a production basis.

(33) The fair market value at July, 1919, of interests in the located lands, the Stock Oil Company lease, the so-called "Iba 80," and the lease from the State of Wyoming acquired by the Wyoming Associated Oil Corporation at the time of its organization was not less than $32,000,000. The fair market value of the 350,000 shares of stock of the company issued for said properties at the time of issuance therefor was not less than $32,000,000.

(34) The fair market value at March 1, 1913, of the interests in located lands, the Stock Oil Company lease, the so-called "Iba 80" and the lease from the State of Wyoming, acquired by the Wyoming Associated Oil Corporation at the time of its organization, plus
37 subsequent cost thereof, was in the hands of the then predecessor owners not less than $14,393,102.54.

(35) The cost of the adverse or conflicting titles acquired by the Wyoming Associated Oil Corporation at the time of its organization in exchange for 50,000 shares of its capital stock, or 1/7th of the capital stock issued for its properties, was not less than $4,600,000.

(36) Assuming that the organization of the Wyoming Associated Oil Corporation was in part a tax-free exchange or reorganization, the basis for computing gain or loss and depletion in the hands of the transferor of the interests in located lands, the Stock Oil Company lease, the so-called "Iba 80," and the lease from the State of

Vyoming, acquired by the Wyoming Associated Oil Corporation, at he time of its organization, was not less than the following:

(a) Cost in January, 1919, of 35.875% minority interest acquired by Salt Creek Producers Association from The Midwest Refining Company for 372,633 shares of its stock	$9,315,825
(b) Fair market value at Feb. 2, 1914, of 5% majority interest transferred by Verner Z. Reed to trust for Margery B. Reed, 5% majority interest transferred in trust for Verner Z. Reed, Jr., 5% majority interest transferred in trust for J. V. Reed—15%	2,250,000
(c) Fair market value at April 3, 1914, of 5% majority interest given by Verner Z. Reed to Mary Dean Reed	750,000
(d) Fair market value at July 10, 1916, of 9% majority interest transferred by Verner Z. Reed to Trust No. 1, and 9% majority interest transferred by him to Trust No. 2	3,150,000
(e) Fair market value at April 20, 1919, of 26.125% majority interest owned by Verner Z. Reed at date of death	7,200,000
(f) To the foregoing should be added, for the purpose of computing the basis for depletion, the cost alleged in Paragraph 35	4,600,000
Total	$27,265,825

38 (37) The reserves of oil, tract by tract, in said properties listed in Exhibit N as of the dates mentioned are as set forth in Exhibit C–1 and C–2 hereof, made a part hereof for all intents and purposes.

(38) Of the property listed in Exhibit E, attached hereto, the properties not involved in the exchange of February 1, 1923, produced, tract by tract, in the period from March 1, 1913, to and including December 31, 1935, the number of barrels, period by period, re as set forth in Exhibits P–1, P–2 and P–3 attached hereto and nade a part hereof for all intents and purposes.

Of the properties listed in Exhibit N, attached hereto, the properties acquired by the Wyoming Associated Oil Corporation on the exchange of February 1, 1923, had as of February 1, 1923, in the reserves of oil set forth in Exhibit O–2, and produced from February 1, 1923, to December 31, 1925, the number of barrels of oil indicated in Exhibit P–3.

The oil properties surrendered by Wyoming Associated Oil Corporation on the exchange of February 1, 1923, produced, period by period, from March 1, 1913, to December 31, 1923, the number of barrels of oil set forth in Exhibits P–1 and P–2.

PRAYER FOR RELIEF

Wherefore, the Petitioner prays that this Board may hear this proceeding and determine:

(a) That the 27½% limitation on depletion allowable for the taxable year 1925 to the Wyoming Associated Oil Corporation be computed on the basis of gross income as defined herein;

(b) That the depletion of the Wyoming Associated Oil Corporation be computed upon the basis of the cost of its depletable properties to it and/or its transferrors, together with such bases as said properties would have for depletion in the hands of the corporation's transferrors;

(c) That the income of the Wyoming Association Oil Corporation from its state school lease be exempted from tax; and

(d) That this Board give such other and further relief as to it may seem proper and advisable, including the refund of
39 all taxes which it may adjudge to have been overpaid by Petitioner or the Wyoming Associated Oil Corporation in affiliation.

Respectfully submitted.

RANDOLPH E. PAUL,
Attorney for Petitioner.
HAROLD D. ROBERTS,
Attorney for Petitioner.

Duly sworn to by John T. Barnett; jurat omitted in printing.

For Exhibit A referred to herein see Exhibit A attached to original petition, for remaining exhibits see exhibits attached to Statement of Evidence.

Before United States Board of Tax Appeals

Answer to amended petition

Filed Jan. 23, 1934

Comes now the respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed in this proceeding admits and denies as follows:

I. Admits the allegations contained in paragraph I of the amended petition.

II. Admits that a notice of deficiency was mailed to the taxpayer on March 14, 1929. Denies the remaining allegations contained in paragraph II of the amended petition.

III. Denies that the Commissioner of Internal Revenue erred in manner and form as alleged in paragraph III, subparagraphs (A), (B), and (C) of the amended petition.

40 IV. Admits the allegations contained in subparagraphs 1, 2, 3, and 30 of paragraph IV of the amended petition. Denies the allegations contained in subparagraphs 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 32, 33, 34, 35, 36, 37, and 38 of paragraph IV of the amended petition.

Admits that the petitioner and the Wyoming Associated Oil Corporation filed for the calendar year 1925 a consolidated income tax return on Form 1120, and that the deficiency notice of March 14, 1929, and the statement attached thereto treat said corporations as being affiliated, as alleged in subparagraph 4 of paragraph IV of the amended petition. Denies all the remaining allegations in the said subparagraph.

Admits that the total depletion allowed by the Commissioner of Internal Revenue in the deficiency letter is $1,674,677.92 as alleged in

subparagraph 31 of paragraph IV of the amended petition. Denies all the remaining allegations in the said subparagraph.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the amended petition be denied.

(Signed) E. BARRETT PRETTYMAN,
General Counsel,
Bureau of Internal Revenue.

Of Counsel: Nathan Gammon, E. L. Corbin, Special Attorneys, Bureau of Internal Revenue.
NG/bj 1/23/34.

Before United States Board of Tax Appeals

Amendment to answer to amended petition

Filed Jan. 31, 1935

Comes now the Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel, Bureau of Internal Revenue, and for amendment to the answer to amend petition admits and denies as follows:

IV. (30) Denies the allegations contained in the first sentence of subparagraph (30) of paragraph IV of the amended petition; admits the allegations contained in the remaining sentence of said subparagraph.

Wherefore, it is prayed that the amended petition be denied.

ROBERT H. JACKSON,
Assistant General Counsel
for the Bureau of Internal Revenue.

Of counsel: R. F. Hertzog, Conway N. Kitchen, Special Attorneys, Bureau of Internal Revenue.
CNK/acb 1/31/35.

Before United States Board of Tax Appeals

Findings of fact and opinion

Promulgated April 23, 1936

1. In computing depletion of 27½ per cent of "gross income from the property" during the taxable year in the case of oil and gas leases the words "gross income from the property" are held to mean under section 204 (c) (2) of the Revenue Act of 1926, the gross amount actually received by the taxpayer as income from the depletable property—not the market price of the oil or gas produced during the taxable year (unless such was received), nor the amount actually received by the taxpayer, increased by any amount expended by one other than the taxpayer, in producing the oil.

2. Where corporation A received income arising from a Wyoming state oil lease by virtue of a declaration of trust in its favor made by corporation B, the owner of such state lease, held, the income of corporation A from such source is not exempt, but is subject to income tax, such tax not being an imposition or burden upon the lease as an instrumentality of the state.

3. Where the Commissioner, in determining petitioner's income tax liability under the Revenue Act of 1926, computed oil depletion allowance of 27½ per cent of gross income, but did not compute and determine what the depletion allowance would be on cost basis, and the petitioner insists that the latter basis would be greater, and facts necessary to determine which computation would result in the greater depletion are stipulated, held, that petitioner is entitled to have a recomputation made under Rule 50, and be allowed depletion on whichever basis is the greater.

Harold D. Roberts, Esq., Randolph E. Paul, Esq., and Charles McInnis, Esq., for the petitioner.

R. P. Hertzog, Esq., Conway N. Kitchen, Esq., and V. F. Weekley, Esq., for the respondent.

The petitioner, Mountain Producers Corporation, is the parent corporation of the Wyoming Associated Oil Corporation. A consolidated return was filed for the year 1925. Petitioner duly appealed from a deficiency in income tax of $90,642.87 determined against it for that year by the respondent, expressed in a deficiency notice of March 14, 1929.

42 An amended petition was filed in 1933, and in 1935 a hearing was had. Stipulations are filed and adopted as a part of our findings of fact, but are set forth herein in connection with other findings of fact on the evidence, only to the extent found necessary for the understanding and determination of the issues involved.

The errors assigned are, in substance, as follows:

1. The decrease in the amount of depletion deduction of the Wyoming Associated Oil Corporation from $2,215,862.23 to $1,674,677.00, asserted to have been based upon a wrong interpretation and application of section 204(c) (2) of the Revenue Act of 1926, in that the depletion computed in the deficiency notice was based upon 27½ per cent of an incorrectly computed gross income.

2. The increase of the net taxable income of the Wyoming Associated Oil Corporation by the restoration thereto of $185,438.83 so-called income from leased state lands.

3. In computing the net income of the Wyoming Associated Oil Corporation and the net income of it and the petitioner, the failure to allow as a deduction depletion based on cost to the Wyoming Associated Oil Corporation and/or its respective transferors and predecessor owners.

Findings of fact

The Mountain Producers Corporation and the Wyoming Associated Oil Corporation are Delaware corporations, the former organ-

ed on May 12, 1920, and the latter on July 11, 1919, the principal ices of both being at the same address in Denver, Colorado.

Throughout the year 1925 the petitioner owned all the capital stock of the Wyoming Associated Oil Corporation. It is stipulated that in computing the income tax liabilities of these corporations for 1925 the net income of the taxpayer should be computed, as in the deficiency notice of March 14, 1929, on a consolidated basis.

Immediately after its organization the Wyoming Associated Oil Corporation received from various parties deeds, assignments, and conveyances covering certain patented lands and interests in oil and gas leases in the Salt Creek Oil Field in Natrona County, State of Wyoming. With respect to these transactions it is stipulated that no Federal tax liability on the part of the Wyoming Associated Oil Corporation was incurred, or if incurred, it was paid.

On February 25, 1920, an act of Congress, known as the Oil and Gas Leasing Act, went into effect and under its so-called relief provisions, particularly those in sections 18, 18 (a), and 19, the lands acquired by the Wyoming Associated Oil Corporation as heretofore described became eligible for exchange into Government leases. Pursuant to said act, in 1920 and 1921 the Wyoming Associated Oil Corporation received from the United States, in lieu of its former placer mining locations, certain leases covering lands listed by governmental subdivisions, under the caption "United States Government Leases," as stipulated herein.

On February 1, 1923, the Wyoming Associated Oil Corporation and the Midwest Oil Co., an Arizona corporation, executed a trust instrument effective throughout the taxable year 1925, wherein and whereby the Midwest Oil Co., the holder of a certain lease from the State of Wyoming, dated October 1, 1919, covering all of school section 36 in Natrona County, Wyoming, agreed to hold in trust for the benefit of the Wyoming Associated Oil Corporation an undivided 50 percent interest in the lease covering section 36, and in the benefits and net proceeds to be realized therefrom and from all renewals and extensions thereof. The trust agreement was to be effective as of February 1, 1923, and to completely supersede and replace all other declarations of interest in favor of the Wyoming Associated Oil Corporation.

On sundry dates between June 1, 1919, and December 31, 1924, the Wyoming Associated Oil Corporation disposed of, by sale or exchange, certain of its properties and interests. As a result of these transactions the Wyoming Associated Oil Corporation on January 1, 1925, owned and held—omitting any reference to section 36—oil lands and interests subject to depletion and from which oil was produced. The number of barrels of oil produced during the year 1925 from the numerous tracts of land and interests covered by the various lease agreements, exclusive of the state school lease (section 36, separately considered) is set forth in detail in stipulation filed and adopted by reference as a part of our findings of fact. Like-

wise, so stipulated and adopted, are the gross income from
44 each property, its field operating expense, income received a
contract price, general and overhead expense, net income o
taxpayer, 27½ per cent of gross income, 50 per cent of net income
and allowable depletion.

During the same period between June 1, 1919, and December 31, 1924, the Wyoming Associated Oil Corporation expended sundry sums of money for the acquisition of adverse titles or outstanding interests in land so held by it, which sums constituted additional capital investment by it in said lands. The amounts have been distributed by the Wyoming Associated Oil Corporation over the several tracts benefited thereby in the amounts and years tabulated and also stipulated.

About February 1, 1923, the Wyoming Associated Oil Corporation, the Midwest Oil Co., and the Wyoming Oil Fields Co. entered into an agreement with the Midwest Refining Co. in which the first three named parties are called "Producing Companies" and the Midwest Refining Co. is called "Refining Company." The producing companies owned certain leases covering lands in the Salt Creek Oil Field, Natrona County, Wyoming, as follows: The Midwest Oil Co. and the Wyoming Associated Oil Corporation each owned an undivided 50 per cent interest in the so-called "Schoonmaker Lease." The Wyoming Associated Oil Corporation and the Wyoming Oil Fields Co. each owned an undivided 50 per cent interest in the so-called "Iba Lease." The Midwest Oil Co. and the Wyoming Associated Oil Corporation each owned an undivided 50 per cent interest in the so-called "Stock Lease." The Midwest Oil Co., for the benefit of itself and the Wyoming Associated Oil Corporation, owned an undivided 50 per cent interest for each in the so-called "State School Lease" covering the aforesaid school section 36.

It was agreed that from February 1, 1923, until January 1, 1934, the producing companies would, subject to certain conditions (not necessary to be here set out), sell, exclusively, unto the refining company all the oil produced from said lands (except oil used for drilling, etc.) upon a sliding scale of prices fully stipulated, but not here necessary to be set out.

From the date of the agreement until January 1, 1934, the producing companies were to give the refining company free use of all storage facilities, pipe lines, buildings, and equipment owned by the
producing companies or either of them, upon said lands also
45 give, free of charge, oil and gas reasonably necessary for drilling, for domestic service, and for production thereon.

The refining company agreed to purchase from the producing companies currently as produced all of the oil of the several producing companies (except oil for drilling, etc.) at the prices indicated in the contract. The contract provided in part:

From the date of this Agreement, until the First day of January 1934, as part of the price for oil purchased hereunder, the Refining

Company will drill, case, and maintain all wells, find and supply water, install and operate pumps. When necessary, clean, shoot, and otherwise stimulate production of wells as necessary, and conduct all development and production operations upon said lands necessary or proper for the protection and conservation of the oil and gas contained therein and for the production of oil therefrom in such amounts and from such wells as will prevent the drainage of the oil content of said lands through wells belonging to other operators, and will, at all times, during said term, maintain the development of and production from said lands at such rate that the production of oil therefrom shall be proportionate to the production of oil in other parts of the Salt Creek Field. * * *

It was further provided in the contract that the "Refining Company will take delivery of the oil purchased hereunder at the outlet gates of the measuring tanks located at or near the wells on said lands."

The contract also provided that:

Section Thirty-six (36) is subject to royalties in favor of the State of Wyoming, and that the other tracts of land are severally subject to various royalties in favor of others, and it is agreed that whenever the State of Wyoming, or any other royalty owner having the right to take his royalty in kind shall elect to exercise such right, then the royalty oil, with respect to which such right is exercised, shall not be subject to this purchase agreement but shall be delivered by the Refining Company to such royalty owner in accordance with such directions as the royalty owner may rightfully give therefor, but the Refining Company shall have the right, if it and royalty owner can reach an agreement, to purchase any such royalty
46 oil from the owner thereof on any terms mutually agreeable to them.

Royalty paid the State of Wyoming was in barrels of oil in kind and such practice prevailed from 1924 to 1934. Royalties taken in kind were divided at the pipe line and payment was made to the three producing companies for their share of the oil after the oils in kind were taken.

When the oil came from the wells it went into the battery tanks, was steamed, impurities taken out, and the clean oil run from the battery tanks to the pipe line; and that part that was delivered to the state was delivered at the battery tanks.

The proceeds of the sale of oil not delivered to the state were divided 50-50 between the Wyoming Associated Oil Corporation and the Midwest Oil Co. in the year 1925.

Before the oil left the battery tanks and went into the gathering lines, a representative of the Wyoming Associated Oil Corporation checked the gauging, supervised the run, and signed the run checks that were forwarded to its Denver office.

The properties—section 36 as well as the others—were operated by the Wyoming Associated Oil Company through the agency of the Midwest Refining Co., the latter conducting the actual operations.

The contract also provided: "The Producing Companies may, at all times, maintain gaugers and inspectors upon their said lands, and shall be furnished by the Refining Company with monthly statements," giving full information as to oil produced from said lands as to certain sales, gross price, etc.

Also, on February 1, 1923, the Wyoming Associated Oil Corporation and the Midwest Refining Co. entered into a contract, the former being referred to therein as "Producing Company" and the latter as "Refining Company." This contract in its terms was identical or in substance the same as the contract last described, with reference to its effective date, duration, sale of oil exclusively to the refining company, upon a sliding scale, etc., stipulated, as are the lands therein involved.

On or about April 19, 1923, the State of Wyoming, through
47 its State Board of Land Commissioners, leased to the Midwest Oil Co. all of the aforesaid section 36, in Natrona County, Wyoming, for the purpose of drilling, boring, operating for, and producing mineral oil and gas for a term of five years beginning on October 1, 1924. The lease agreement is lengthy and its many provisions and conditions need not be here set out. As a consideration for the lease a certain royalty was to be paid by making "delivery of the royalties in kind * * * to the Mutual Oil Company as the representative" of the state. No assignment of the lease was permitted without the consent of the state. The lease was executed by the president of the State Board of Land Commissioners and the Midwest Oil Co. The lease was to be construed under the provisions of the laws of the State of Wyoming. It supplanted a somewhat similar lease which bore date of October 1, 1919. It was agreed in the latter lease that its execution constituted a surrender of a lease of the same section, dated December 31, 1914, though December 26, 1914, was evidently intended. The lease of December 26, 1914, was of the same section, between the same parties and for the period of five years from January 1, 1915. This lease provided that as a consideration for the granting of the lease the Midwest Oil Co. agreed to surrender to the State of Wyoming its lease to the same land dated January 4, 1910, issued to William M. Fitzhugh and assigned by him to the Midwest Oil Co., and it was expressly "stipulated and agreed by the parties hereto that said lease and all the rights of the party of the second part thereunder shall cease and terminate at midnight of the night of December 31, 1914."

The lease of January 4, 1910, by the State of Wyoming to William M. Fitzhugh above referred to was for a period of five years from that date, money royalties to be paid in advance, annually, on January 4th of each year.

It is stipulated that if the Board should find that the amount of $185,438.83 added to taxable income in the deficiency notice is exempt from taxation, then the deductions allowed in the deficiency notice should be reduced in the amount of $45,927.12 representing the deple-

tion applicable to this income, and in the amounts of $5,602.81 and $18,431.11 representing taxes and royalties which were allowed as deductions in the deficiency notice.

48 The average field price of oil or market price of oil in the Salt Creek Field, Wyoming, during the year 1925 was $1.808605 per barrel.

The consolidated return filed by the Mountain Producers Corporation and the Wyoming Associated Oil Corporation for the year 1925 was on an accrual basis and did not include as income any amount expended by the Midwest Refining Co. under contracts made by it with the Wyoming Associated Oil Corporation, the Midwest Oil Co., and the Wyoming Oil Fields Co., and none of said amounts were entered as income on the books of the Wyoming Associated Oil Corporation or the Mountain Producers Corporation. Said return included in gross income the net prices actually received pursuant to said contracts. The return computed depletion, in so far as depletion consisted of 27½ per cent of the gross income from the property, by taking 27½ per cent of an amount consisting of the barrels of oil produced from the properties of the company at the market price of oil in the field at the date of production.

The fair market value at February 2, 1914, April 3, 1914, and April 10, 1916 (so recited in stipulation, though July 10, 1916, probably intended), of the interests transferred in trust on those dates to predecessor owners of the Wyoming Associated Oil Corporation as set forth in the stipulation is agreed to be, for the purposes of this proceeding, the fair market value at March 1, 1913, of the same interests in said properties, and the total value of the interests transferred as stated on above dates, it is agreed, aggregates 38 per cent of the fair market value of March 1, 1913. It is further agreed that a true copy of the deficiency notice is attached to the amended petition herein.

For the year 1925 the petitioner paid a total income tax of $271,342.32 at the dates and in the amounts set forth in the following schedule:

Mar. 15, 1926	$73,050.35
July 1, 1926	57,402.69
Aug. 19, 1926	5,218.12
Sept. 11, 1926	67,835.58
Dec. 14, 1926	67,835.58
	271,342.32

49 The income tax return of petitioner herein was filed in the office of the collector of internal revenue for the district of Colorado at Denver, Colorado.

The unrecovered capital sum of the Wyoming Associated Oil Corporation as of January 1, 1925, returnable through depletion upon the basis of cost, but without any reference to percentage depletion as provided for in section 204 (c) (2) of the Revenue Act of 1926, of the rights, properties, and interests of the Wyoming Associated

Oil Corporation owned and held as of January 1, 1925, omitting any reference to the aforesaid school section 36, is stipulated and in the aggregate amounts to $11,607,199.93.

The unrecovered capital sum of the Wyoming Associated Oil Corporation as of January 1, 1925, returnable through depletion upon the basis of cost, but without any reference to percentage depletion as provided for in section 204 (c) (2), supra, with respect to the aforesaid school section 36 is $233,817.

Opinion

Seawell: 1. There is no controversy as to the right of the Wyoming Associated Oil Corporation to an allowance for depletion on its interest in the properties in question; nor is there any dispute as to what the allowable depletion is, on the basis of cost, which is stipulated. The main problem for consideration and determination is what is meant by "gross income" for the purpose of computing depletion on the percentage basis. There is no disagreement on the proposition that the taxpayer may avail itself of whichever basis results in the greater depletion.

Under the contracts between the Wyoming Associated Oil Corporation and the Midwest Refining Co., the latter company took delivery of the oil purchased "at the outlet gates of the measuring tanks located at or near the wells."

The average field price of oil or market price of oil in the Salt Creek Field, Wyoming, during the year 1925 was $1.808605 per barrel. In behalf of the Wyoming Associated Oil Corporation (and in behalf of petitioner) it is contended that the "gross income" upon which depletion allowance of 27½ per cent applies should be based on the market value of the oil produced or at least on the amount
50 actually received, plus the operating expenses of the Midwest Refining Co., which in the consolidated return was claimed as $2,215,862.23, now stipulated to be $2,816,520.04.

Section 204 (c) (2) of the Revenue Act of 1926 provides:

In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

It is specifically stated in the statute that the allowance for depletion shall not exceed 50 per cent of the "net income of the taxpayer (computed without allowance for depletion) from the property." We are of the opinion and hold that, in arriving at the amount of depletion allowable under said section, development expense should not be deducted from the gross income from the property in arriving

it the net income therefrom for the purpose of applying the depletion limitation of 50 per cent of the net income. See Ambassador Petroleum Co. v. Commissioner, — Fed. (2d) — (Feb. 5, 1936); 9110, C. C. H. 1936, vol. 3. In the instant case, in our opinion, it is logical to conclude that the words "gross income" to which the rate of 27½ per cent applies means the gross income of the Wyoming Associated Oil Corporation for the year 1925 from its property subject to depletion. See Everett J. Crews, 33 B. T. A. 36, 49.

It is argued in behalf of the petitioner that in the particular circumstances of the instant case, if the allowance for depletion on a percentage basis is limited to 27½ per cent of the amount actually received by the Wyoming Associated Oil Corporation for the oil produced from the properties subject to depletion, it does not receive as great an allowance as if it were operating the properties itself, since in that event the amount it received from the oil would be greater. Such might be the situation of any owner of oil properties which does not choose to operate its properties itself. It is the insistence of the respondent that the amount received by any holder of an interest in oil properties other than the one actually operating the property is the gross income which is subject to the 27½ per cent depletion deduction, and, regardless of the fact that such amount is net in so far as the costs of producing the oil is concerned, the taxpayer is not permitted in such cases to base the percentage allowance on the amount received plus the cost of operations or on the market price of the oil produced. If the base determined by the respondent for computing percentage depletion is not considered satisfactory, the taxpayer, as we have heretofore indicated, may compute its allowance for depletion on the basis of cost, if that method results in a greater depletion allowance. See section 204 (a) and (b) of the Revenue Act of 1926. Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312.

51

There are numerous cases involving the application of percentage depletion, but we are aware of none in which the peculiar circumstances shown in the instant case were present.

In Helvering v. Twin Bell Oil Syndicate, supra, the question for decision was as to the total allowance for depletion permitted and its apportionment between lessor and lessee where the income is derived from operation under an oil and gas lease. The Supreme Court decided the depletion allowance permitted an assignee or lessee named in an oil and gas lease should be limited to 27½ per cent of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer. The lessor, likewise, was entitled to a depletion allowance of 27½ per cent of the gross income received by it from the oil and gas production. The royalties paid out by the Twin Bell Oil Syndicate were obviously a part of the gross income from the property, but nevertheless as held by the Supreme Court

the royalties so paid could not be considered a part of the gross income to be used for computing the depletion allowable to the taxpayer.

It is insisted in behalf of the petitioner that under the provisions of the agreements with the Midwest Refining Co., whereby the properties were operated, the cost of the operations and development expenses were a part of the purchase price paid the Wyoming Associated Oil Corporation for the oil and should, therefore, be considered as a part of the "gross income from the property." It is not shown that the Wyoming Associated Oil Corporation included in its return for 1925 any such expense as part of its gross income.

52 Such expense as the Midwest Refining Co. incurred in rendering alleged services to the Wyoming Associated Oil Corporation, under circumstances shown, was not, in our opinion and we so hold, income to the latter.

Under the contract between the parties, the petitioner contends that the market value of the oil produced should be taken as the gross income for the purpose of computing percentage depletion, on the theory that the value of the services rendered by the Midwest Refining Co. in operating the leases was a part of the purchase price of the oil and that the value of such services should be assumed or considered to be the difference between the market value of the oil and the contract price.

There is, in our opinion, no sound basis for the assumption that the value of the services rendered by the Midwest Refining Co. in producing the oil should be considered as a part of gross income of the Wyoming Associated Oil Corporation. It is natural and reasonable, however, to assume that the Midwest Refining Co., by purchasing all of the oil which was produced under the leases in question for a number of years and assuming the burden and risks incident to the operation and development thereof during that period, paid less for the oil than if it were buying the oil on the open market after it was produced and without assuming any burden in connection therewith. The value fixed or placed by the parties upon the services rendered would seem to be none other than the actual cost of such services, which is the amount actually expended by the Midwest Refining Co. in producing the oil and not necessarily the difference between the market value and the contract price of the oil. There is no evidence nor reason apparent to us to justify the assumption that such costs as stipulated do not represent the full costs of operation of the properties.

Cases in which taxpayers are permitted to use the field market price for the purpose of computing depletion are those in which the product was not sold until it had been converted into a refined product or transported a considerable distance to the consumer. A portion of the selling price in that event naturally represented an amount received for the conversion or for the transportation which can not be used as the basis for computing depletion. See Brea Canon Oil Co., 29 B. T. A. 1134; affd., 77 Fed. (2d) 67; certiorari denied—

U. S.—(Oct. 14, 1935); Consumers Natural Gas Co., 30 B. T. A.
53 1263; affd., 78 Fed. (2d) 161; certiorari denied—U. S.—(Oct. 28, 1935); Greensboro Gas Co., 30 B. T. A. 1362; affd., 79 Fed. (2d) 701; certiorari denied—U. S.—(Nov. 11, 1935).

In the class of cases cited, supra, it was necessary to allocate amount received, and the market price of the oil was assumed to be the portion of the selling price which was received for the raw product, the balance representing the amount attributable solely to manufacturing and transporting the product.

The market price of the oil in those cases was merely used as a basis of allocation of the total amount received in the absence of a more definite basis for determining the amount of gross income subject to depletion or in cases where the gross income could not be otherwise ascertained.

In the instant case the Wyoming Associated Oil Corporation did not conduct any manufacturing operations or transport the product to individual consumers; in fact, it did not itself operate the property and produce the raw material. There is, therefore, nothing to allocate or segregate in this case.

The respondent allowed percentage depletion on the gross income which the Wyoming Associated Oil Co. is shown to have actually received in 1925 pursuant to the contracts entered into in 1923, and to allow such sum to be arbitrarily increased by the amount of operating expenses of the Midwest Refining Co. or to the market price of the oil in effect during 1925, we hold, would be allowing the Wyoming Associated Oil Corporation depletion on a basis in excess of that authorized by the statute. Any allowance for depletion is a matter of grace and unless Congress has provided for depletion there can be no deduction therefor. Darby-Lynde Co. v. Alexander, 51 Fed. (2d) 56; certiorari denied, 284 U. S. 666. Congress no doubt intended that the allowance for depletion be as uniform as possible, though at times it might appear that there were "unjust and unequal results." Helvering v. Twin Bell Oil Syndicate, supra.

The fact that the Wyoming Associated Oil Corporation, by reason of its failure to operate its oil properties itself, may receive, as heretofore indicated, less depletion than it would have received had
54 it operated them or less than other taxpayers who operated their own similar properties is immaterial. There are many reasons why the depletion allowance to the taxpayer may not be the same where it operates the properties and where it does not. Many different facts and circumstances must be taken into consideration in determining the depletion in different cases and naturally, in consequence, depletion results may vary. While this was well known to Congress, it provided, as one of the methods that a taxpayer might adopt, that depletion may be computed at the rate of 27½ per cent of the gross income, though such income would vary in different cases and under different circumstances, as all taxpayers would not receive the same prices for their product and some might operate their prop-

erties themselves while others might do so through others, as was done in the instant case. In other words, Congress saw proper to base percentage depletion allowance on gross income actually received by the taxpayer from its property or interests therein.

The record shows that the respondent in his computation of the 27½ per cent depletion used as a base the amount of gross income which the Wyoming Associated Oil Corporation actually received from the Midwest Refining Co. during 1925. We are of the opinion and hold that no error was committed in using such base for that computation. We think, for reasons briefly stated herein, that the base for computing percentage depletion should not, in the particular circumstances of this case, be either the market price of the oil produced from the said properties or the amount of money received by the Wyoming Associated Oil Corporation from sale of oil to the Midwest Refining Co. increased by the amount of the cost of services rendered by the Midwest Refining Co. in the matter of the oil production.

2. The second assignment of error is based primarily on the decision of the Supreme Court of the United States in Burnet v. Coronado Oil & Gas Co., 285 U. S. 393. In that case, which followed the court's earlier decision in Gillespie v. Oklahoma, 257 U. S. 501, the Supreme Court held that the income derived by the Coronado Oil & Gas Co. under oil and gas leases executed to it by the state upon portions of the public school lands of the state was exempt from Federal income tax, for the reason that the leases to the said company were instrumentalities of the state for the purpose of "carrying
55 out her duty in respect of public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself." In so deciding, the court stated that the doctrine of Gillespie v. Oklahoma, supra, should be applied "strictly and only in circumstances closely analogous to those which it disclosed."

The respondent contends that the circumstances of the instant case are not "closely analogous" to those in Burnet v. Coronado Oil & Gas Co., supra; that the instant case is clearly distinguishable from it and, therefore, not controlled by the principle therein enunciated and applied.

On February 1, 1923, a trust agreement was entered into between the Midwest Oil Co. and the Wyoming Associated Oil Corporation, under which the Midwest Oil Co. was to hold in trust for the Wyoming Associated Oil Corporation one-half the benefits and net proceeds realized by the Midwest Oil Co. from a lease of October 1, 1919, which it held from the State of Wyoming, covering school section 36 embraced in the trust.

The lease agreement of October 1, 1919, was superseded by another lease, dated April 19, 1923, between the same parties.

It was this latter lease that was in force during the taxable year (1925) involved herein. It was executed between the State of Wyo-

ming and the Midwest Oil Co. solely. It contained a provision against assignment to any one without the consent of the State of Wyoming. The record does not disclose any assignment thereof, either with or without such consent.

The income which the Wyoming Associated Oil Corporation received from the aforesaid school section 36, held by the Midwest Oil Co., was by virtue of the declaration of trust of February 1, 1923, made by the Midwest Oil Co. prior to the lease of April 19, 1923, which superseded that of October 1, 1919. There was no lease of said land to the Wyoming Associated Oil Corporation by the State of Wyoming. The Wyoming Associated Oil Corporation had no contractual relationship with the State of Wyoming, which leased said school land section in question to the Midwest Oil Co., solely.

The burden of operating the lease, the payment of royalties, and the responsibility for compliance with the numerous provisions of
56 the lease agreement rested directly upon the Midwest Oil Co., which was solely responsible to the State of Wyoming. The declaration of trust under which the Wyoming Associated Oil Corporation realized its income from this school land, in our opinion, is not an instrumentality of the State of Wyoming through which the state exercised sovereign power of maintaining and operating its public schools. Therefore, the situation, in so far as the Wyoming Associated Oil Corporation is concerned, not only is not "closely analogous" to the situation in Burnet v. Coronado Oil & Gas Co., supra, but is different in the material point which entitled the Coronado Oil & Gas Co. to tax immunity in that case.

The facts and circumstances in the instant case are not in all respects the same as those in Wanless Iron Co., 29 B. T. A. 834; affd., 75 Fed. (2d) 779; certiorari denied, 295 U. S. 765, but, in our opinion, are sufficiently similar in their essential aspects to make applicable and controlling, on the issue now being discussed, the principles therein enunciated and the authorities therein cited. In the Wanless Iron Co. case, supra, the petitioner claimed exemption from tax on income realized by it on certain mineral lands owned by the State of Minnesota and leased to one Wanless, who assigned the leases to the petitioner therein, and, subject to subsequent subleases, the petitioner had since been the owner of the leases. Neither the original lessee and assignor nor the petitioner, the assignee and sublessor, ever extracted or sold ore from the lands. The sublessees were the only ones that produced and sold ore from the lands. The royalty paid the state was by the sublessees. The petitioner there paid no royalty to the state. Its claim of tax exemption in the circumstances of that case was denied by the Board, and the determination of the Board was affirmed by the United States Circuit Court of Appeals, as heretofore stated.

In the Wanless case the original lease provided that the lessee might sublet the same. In the instant case there was no such provision, but, on the contrary, one against assignment without approval of the state, the laws of Wyoming forbidding the assignment of state mineral

leases except upon its written consent. See Wyoming Revised Statutes, 1931, Ann., ch. 91, art. 806.

Under the agreement of February 1, 1923, referred to in our findings of fact, it is the Midwest Refining Co. that contracted to do the
57 actual operations under certain leases (which included the school land heretofore mentioned) in the Salt Creek Oil Field.

As stated by the Court of Claims in Marland v. United States, 3 Fed. Supp. 611, "The immunity from taxation applies only where the tax would be a real and direct burden upon the state's exercise of its governmental functions." See same case, 53 Fed. (2d) 907; certiorari denied, 290 U. S. 658. There is no proof here that the tax asserted would be a "real and direct burden" upon the State of Wyoming. Nothing in the record indicates that the imposition or payment of the tax asserted in this instance would in any way burden or interfere with the state in the exercise of its governmental functions. The execution of the declaration of trust of February 1, 1923, which entitled the Wyoming Associated Oil Corporation to share equally with the Midwest Oil Co. in the benefits and proceeds derived from the lease of section 36, was a distinct transaction and trust between private owners to which the state was not a party and the income realized as a result thereof is, in our opinion, in the same status as income realized from the sale of a state lease, which was held not to be exempt in the Marland case above cited and in Rice Oil Co. v. United States, 7 Fed. Supp. 414. Se' also Willcutts v. Bunn, 282 U. S. 216, in which an exemption was denied to income realized from the sale of municipal bonds the interest on which is exempt from tax. Eckstein v. United States, 10 Fed. Supp. 231 (Ct. Cls.); Hobart Iron Co., 29 B. T. A. 855; and Bankline Oil Co., 33 B. T. A. 910. Cf. Metropolitan Building Co. v. United States, 12 Fed. Supp. 537.

The income which the Wyoming Associated Oil Corporation received from the said school land section 36 was by virtue of the declaration of trust in its favor by the Midwest Oil Co. Such did not create any privity of contract or constitute any contractual relationship whatever with the State of Wyoming.

It is insisted by petitioner's counsel that the exclusion from consideration herein of oral evidence tendered for the purpose of showing that the State of Wyoming recognized the Wyoming Associated Oil Corporation as its direct lessee of said school section is error. The evidence offered was received in order that the record might show what it was, but it was with the understanding that it would be stricken as inadmissible upon respondent's objection then
58 made, petitioner's counsel being granted an exception to such action so taken. We think and hold that in so ruling no error was committed. The lease of the school section of land by the State of Wyoming was made in writing to the Midwest Oil Co. and only to it. The oral testimony offered and excluded from consideration in the determination of the issue involved would (if admitted and con-

sidered) have violated a well recognized rule of evidence. "Parol testimony can not be received to contradict, vary, add to or subtract from the terms of a valid written instrument." Jones on Evidence (Civil Cases, 3d Ed.), sec. 434, p. 656. See also Garden City Feeder Co. v. Commissioner, 75 Fed. (2d) 804; Pugh v. Commissioner, 49 Fed. (2d) 76, in effect affirming 17 B. T. A. 429; certiorari denied, 284 U. S. 642.

After carefully considering the evidence, arguments, and authorities relative to this issue, though all have not been discussed herein, we are of the opinion and hold that the respondent did not err in his determination that the $185,438.83 added to taxable income in the deficiency notice is not exempt, but is subject to income tax.

3. The third assignment of error relates to depletion and the costs basis to be used in computing depletion in lieu of percentage depletion in the event that depletion based on cost should be greater than such percentage depletion. The stipulations enumerate the numerous tracts involved, including the aforesaid section 36, and state as to each the unrecovered capital sum returnable on January 1, 1925, through depletion upon the basis of cost.

The petitioner contends that it is entitled to a greater amount of depletion than was allowed under the percentage computations as computed and allowed by the respondent. We have herein determined the principles to be applied in determining the 27½ per cent depletion based upon gross income and also those applying to depletion based on cost.

Under the facts as stipulated and established by evidence, we are of opinion and hold that the petitioner is entitled to a recomputation under Rule 50 and to have allowed as depletion whichever amount is the greater—depletion based upon cost, or percentage depletion based upon gross income computed as we have indicated.

Decision will be entered under Rule 50.

59 Before United States Board of Tax Appeals

Decision

Pursuant to the findings of fact and opinion promulgated in the above-entitled proceeding on April 23, 1936, counsel for the respondent having filed a proposed final determination with notice of settlement, due notice of hearing under Rule 50 having been served on counsel for the parties; and at the hearing held on June 24, 1936, counsel for the petitioner having failed to contest the proposed final determination of the respondent, now, therefore, it is

Ordered and Decided that there is a deficiency in income tax for the year 1925 in the amount of $67,509.13.

[SEAL] (Signed) STEPHEN J. MCMAHON,
Member.

Entered June 25, 1936.

In United States Circuit Court of Appeals

Petition for review of decision of the United States Board of Tax Appeals and assignments of error

Filed Sept. 14, 1936

To the Honorable Judges of the United States Circuit Court of Appeals for the Tenth Circuit:

The above-named petitioner hereby petitions for a review of the decision of the United States Board of Tax Appeals promulgated in the above-entitled case April 23, 1936, a final decision having been entered June 25, 1936, and respectfully shows to this Honorable Court as follows:

I. DESIGNATION OF COURT OF REVIEW

The petitioner on review (hereinafter referred to as the "petitioner") is a corporation organized on May 12, 1920, under the laws of the State of Delaware, with its principal office at Denver, Colorado.

During the calendar year 1925 and at all other times material to this case the petitioner owned all of the capital stock of the Wyoming Associated Oil Corporation (hereinafter referred to as the "Operating Company"), a corporation organized on July 11, 1919, under the laws of the State of Delaware, with its principal office at Denver, Colorado. During and throughout the year 1925, the petitioner and the Wyoming Associated Oil Corporation were affiliated in a "Class A" relationship within the purview of Section 240
60 of the Revenue Act of 1926, and filed for the year 1925 a consolidated income tax return on Form 1120 under the name of Mountain Producers Corporation as the parent corporation. The said return was filed with the Collector of Internal Revenue at Denver, Colorado, whose office is located within the jurisdiction of the United States Circuit Court of Appeals for the Tenth Circuit.

The respondent on review (hereinafter referred to as the "Commissioner") is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

The petitioner, being aggrieved by the said decision of the United States Board of Tax Appeals rendered in the above-entitled case, desires a review thereof by the United States Circuit Court of Appeals for the Tenth Circuit, in accordance with the provisions of Sections 1001 to 1003, inclusive, of the Revenue Act of 1926, as amended by Section 519 of the Revenue Act of 1934.

II. STATEMENT OF THE NATURE OF THE CONTROVERSY

During and throughout the year 1925 the Wyoming Associated Oil Corporation (referred to herein as the "Operating Company")

owned and operated a number of leases controlling the production of oil from the Salt Creek Field in Natrona County, State of Wyoming. A majority of the leases had been acquired from the federal government under the so-called Leasing Act of February 25, 1920, by the surrender of its former placer mining claims. A few of the leases had been obtained from fee owners of patented lands, and an undivided one-half interest in one lease covering Section 36 (hereinafter referred to as the "State School Lease") had been obtained from the State of Wyoming. The State School Lease and a few of the other leases were owned jointly with the Midwest Oil Company and the Wyoming Oil Fields Company (two other producing companies in the Salt Creek Field).

All of the oil produced by the Wyoming Associated Oil Corporation (the Operating Company) under its leases in the Salt Creek Field, during the year 1925, was sold to the Midwest Refining Company under two contracts dated February 1, 1923. One of the contracts of February 1, 1923, covered the sale of oil produced
61 under the leases owned jointly by the Wyoming Associated Oil Corporation, the Midwest Oil Company, and the Wyoming Oil Fields Company, including the State School Lease. The other contract of February 1, 1923, covered the sale of oil produced under the leases owned entirely by the Wyoming Associated Oil Corporation. Under each of the two contracts of February 1, 1923, which were identical in substance with the exception of the parties thereto, the three companies owning the leases, referred to therein as the "Producing Companies," agreed to sell to the Midwest Refining Company, referred to therein as the "Refining Company" all of the oil produced from the designated leases during the period from February 1, 1923, until January 1, 1934, upon a sliding scale of prices fully stipulated therein, which prices were considerably below the average price being paid for similar oil in the Salt Creek Field.

As part of the purchase price of the oil to be produced from the said leases, the "Refining Company" agreed to "drill, case and maintain all wells, find and supply water, install and operate pumps when necessary, clean, shoot and otherwise stimulate production of wells as necessary, and conduct all development and production operations upon said lands necessary or proper for the protection and conservation of the oil and gas contained therein and for the production of oil therefrom in such amounts and from such wells as will prevent the drainage of the oil content of said lands through wells belonging to other operators." Appropriate provision was made in the contract covering the sale of oil from the jointly-owned leases for the payment to the designated representative of the State of Wyoming of the state's royalty from Section 36 (the State School Lease) of oil in kind.

All of the oil produced from the leases of the Wyoming Associated Oil Corporation during the year 1925, with the exception of the royalty paid to the State of Wyoming in kind from the School Lease,

was sold to the "Refining Company" at the prices designated in the two contracts of February 1, 1923, and the "Refining Company," in addition to paying the prices designated in the contract for the said oil, performed the services which it had agreed to perform in the two contracts. The average field price of oil, or market price of oil, in the Salt Creek Field, Wyoming, during the year 1925, was $1.808605, whereas the average amount received in cash by the
62 Wyoming Associated Oil Corporation for the sale of its oil under the above-mentioned contracts of February 1, 1923, was approximately $1.25 per barrel.

In computing depletion at the rate of 27½% of the gross income from the leases owned by the Wyoming Associated Oil Corporation during the year 1925, under Section 204 (c) (2) of the Revenue Act of 1926, the Commissioner applied the 27½% rate only to the actual cash received from the "Refining Company," and refused to take into consideration, as part of the gross income of the Wyoming Associated Oil Corporation, the value of the services performed for that company by the "Refining Company," as part of the purchase price of the oil under the contracts of February 1, 1923. The taxpayer took the position that the application of the 27½% rate to the average field price of similar oil during the year 1925 would be the most equitable way of allowing for the additional consideration and income received in the form of services, but that in any event the taxpayer was, at the very worst, entitled to have included in the gross income subject to depletion the actual cost of the services performed by the "Refining Company" which was stipulated to be in the amount of $2,816,520.04. The Board of Tax Appeals approved the action of the Commissioner.

During and throughout the year 1925 the Wyoming Associated Oil Corporation owned and operated an undivided one-half interest in a lease dated April 19, 1923, between the State of Wyoming and the Midwest Oil Company, covering the production of oil and gas from Section 36 in the Salt Creek Field (the "State School Lease"). The said lease was held by the Midwest Oil Company under a trust agreement dated February 1, 1923, whereby one-half of the benefits and net proceeds from the said lease was held in trust for the Wyoming Associated Oil Corporation. The State School Lease, dated April 19, 1923, had superseded a prior lease dated October 1, 1919, between the same parties, which had in turn superseded another prior lease dated December 26, 1914, between the same parties. The lease of December 26, 1914, had in turn superseded a prior lease covering the same section dated January 4, 1910, between the State of Wyoming and William M. Fitzhugh. In obtaining the lease of January 4, 1910, William M. Fitzhugh had acted for a mining partnership consisting of himself and eighteen other individuals. The interests of the
63 respective partners were unequal. During the year 1911 William M. Fitzhugh and one other of said partners, acting separately from the other members of said partnership, sold their interests in said lease to The Midwest Oil Company. During the same

year the other seventeen members of said partnership negotiated the sale of their interests in said lease (purchase price paid in 1912) to certain other corporations through which it passed to The Wyoming Associated Oil Corporation. In renewing the lease each time, the Midwest Oil Company acted not only in its own behalf but also as trustee for the owner or owners of that part thereof which was subsequently acquired by the Wyoming Associated Oil Corporation.

The Wyoming Associated Oil Corporation was considered by the Midwest Oil Company, the Midwest Refining Company, the State of Wyoming, and all other persons having contact with the oil produced from Section 36, as owning, throughout the year 1925 and at all times material to this case, an undivided one-half interest in the said lease from the State of Wyoming covering the said section.

The State School Lease and the other jointly-owned leases, together with the leases owned entirely by the Wyoming Associated Oil Corporation, were operated during the year 1925 by the owners thereof, through the agency of the Midwest Refining Company (the company referred to as the "Refining Company" in the contracts of February 1, 1923), the latter conducting the actual operations. The Wyoming Associated Oil Corporation maintained throughout the year 1925 and at all times material to this case, a representative in the field who supervised the operations of the "Refining Company," checked all oil produced from the leases, signed the delivery receipts, and kept his company advised of all drilling and production operations.

When the oil came out of the ground it was delivered to battery tanks where it was steamed and the impurities taken out. It was then delivered to the pipe line for transmission to the "Refining Company," the purchaser under the contracts of February 1, 1923. Payment was made by the "Refining Company" directly to the Wyoming Associated Oil Corporation and the other two "Producing Companies."

The oil produced from the State School Lease was handled in exactly the same manner as the other oil except that the
64 royalty to the State of Wyoming was first paid in kind by delivery of oil to its designated representative. Payment for one-half of the net production from the State School Lease (after the payment of the royalty in kind) was made by the "Refining Company" directly to the Wyoming Associated Oil Corporation as the owner of an undivided one-half interest in the said lease.

The Act of Congress of July 25, 1868 (15 Stat. at Large 178) creating the territory of Wyoming, reserved Sections 16 and 36 in each township for "public schools." Article VII, Sections 1, 2, 4, 6, and 7, and Article VIII, Sections 1 and 2, of the proposed constitution adopted by the people of Wyoming Territory during the years 1889 and 1890, provided that the new state should accept the public land grants for educational purposes, and Article VIII, Section 2, provided that the proceeds of the state lands should "be inviolably appropriated and applied to the specific purposes specified in the original grant or gifts." The United States Congress, with the proposed

Wyoming constitution before it, created the State of Wyoming by an "Act of Admission." Section 4 of the Act of Admission of July 10, 1890 (26 Stat. at Large 222) confirmed the previous territorial grant of sections 16 and 36 to the state for the support of common schools. Section 36 in the Salt Creek Field was received by the State of Wyoming under the above-mentioned Act of Admission, and the proceeds received by the state from the above-mentioned leases covering the said Section have been used by the state exclusively for its public schools. All of the royalty received by the state from the production of oil and gas under the said lease during the year 1925 was used for that purpose.

The Commissioner has included in taxable income of the Wyoming Associated Oil Corporation, for the year 1925, the amount received by it during that year for its one-half of the net production from the State School Lease and the Board of Tax Appeals has approved that action.

At the hearing before the United States Board of Tax Appeals the petitioner offered evidence to show that representatives of the Wyoming Associated Oil Corporation participated in the negotiations with the representatives of the State of Wyoming which culminated in the lease of April 19, 1923, and that the representatives of the State of Wyoming dealt with and communicated with
65 the Wyoming Associated Oil Corporation as the owner of an undivided one-half interest in the said lease, but the testimony was stricken by the presiding member.

The petitioner also offered testimony to show that subsequent to the year 1925 a joint lease was entered into between the State of Wyoming, as lessor, and the Midwest Oil Company and the Wyoming Associated Oil Corporation, as lessees, covering the production of oil from the said section 36, but the said evidence was stricken by the presiding member.

III. Assignment of Error

The petitioner now says that in the record and proceedings before the United States Board of Tax Appeals and in the findings of fact, opinion, and decision promulgated and entered by said Board, manifest error occurred and intervened to the prejudice of the petitioner, and the petitioner says the following errors and each of them, which it avers occurred in said record, proceedings, findings of fact, opinion, and decision, upon which it relies to reverse the said findings of fact, opinion, and decision so rendered and entered by the United States Board of Tax Appeals are as follows:

(1) The United States Board of Tax Appeals erred in not holding and deciding that the allowance for depletion at the rate of 27½% of the gross income from the property of the Wyoming Associated Oil Corporation, under Section 204 (c) (2) of the Revenue Act of 1926, for the calendar year 1925, should be computed at 27½% of the gross field price of a similar grade of oil in the Salt Creek Field during the year in question.

(2) The United States Board of Tax Appeals erred in failing to find, in the alternative, that the 27½% depletion allowable to the Wyoming Associated Oil Company for the year 1925, under Section 204 (c) (2) of the Revenue Act of 1926, should be computed on the amount of cash received by it under the contracts of February 1, 1923, plus the amount expended by the Midwest Refining Company on its behalf in performing the services referred to in the contracts of February 1, 1923.

(3) The United States Board of Tax Appeals erred in determining that the 27½% depletion allowable to the Wyoming Associated Oil Corporation under Section 204 (c) (2) of the Revenue Act of 1926, for the calendar year 1925, should be computed solely on the amount of cash received by the Wyoming Associated Oil Corporation from the Midwest Refining Company under the contracts of February 1, 1923.

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(4) The United States Board of Tax Appeals erred in failing to find that the amounts expended by the Midwest Refining Company on behalf of the Wyoming Associated Oil Corporation in drilling, casing, maintaining, and operating wells on the leases owned by Wyoming Associated Oil Corporation and in performing the other services enumerated in the contracts of February 1, 1923, constituted part of the gross income of the Wyoming Associated Oil Corporation within the meaning of Section 204 (c) (2) of the Revenue Act of 1926.

(5) The United States Board of Tax Appeals erred in holding and deciding that the amount received by the Wyoming Associated Oil Corporation as its one-half of the net proceeds from the operation of the State School Lease covering Section 36 in the Salt Creek Field, constituted taxable income to the Wyoming Associated Oil Corporation.

(6) The United States Board of Tax Appeals erred in failing to find as a fact that the Wyoming Associated Oil Corporation owned and operated one-half of the lease from the State of Wyoming covering section 36 of the Salt Creek oil field.

(7) The United States Board of Tax Appeals erred in excluding evidence proffered by the petitioner showing that the representatives of the Wyoming Associated Oil Corporation participated in the negotiation of the lease covering Section 36 and that the officials of the State of Wyoming having charge of the leasing of said Section have consistently dealt with and recognized the Wyoming Associated Oil Corporation as being the owner of one-half of the said lease.

(8) The United States Board of Tax Appeals erred in excluding evidence proffered by the petitioner showing that representatives of the Wyoming Associated Oil Corporation participated in a conference with representatives of the Midwest Oil Company and representatives of the State of Wyoming in September, 1929, which resulted in another lease to Midwest Oil Company and Wyoming Associated Oil Corporation covering Section 36.

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(9) The United States Board of Tax Appeals erred in excluding evidence proffered by the petitioner showing that the petitioner was

contending before the Commissioner, at the time that the lease dated April 19, 1923, was executed, that income from Section 36 was exempt from federal taxation.

(10) The United States Board of Tax Appeals erred in not rendering judgment for the petitioner for the year 1925 on each of the issues raised in the petition to the said Board for the reason that any other judgment is not supported by competent and substantial evidence nor according to law.

Wherefore, the petitioner petitions that the decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Tenth Circuit; that a transcript of record and a statement of evidence be prepared in accordance with law and with the rules of said court, and transmitted to the Clerk of the said court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said court.

(Signed) HAROLD D. ROBERTS,
First National Bank Building,
Denver, Colorado.

(Signed) RANDOLPH E. PAUL,
40 Wall Street, New York, N. Y.

(Signed) CHARLES B. MCINNIS,
Transportation Building, Washington, D. C.
Attorneys for Petitioner.

[*Duly sworn to by Harold D. Roberts; jurat omitted in printing.*]

68 Sworn to and subscribed before me this 9th day of September 1936. (Signed) Emil W. Anderson, Notary Public. (Seal) My commission expires August 22, 1937.

Before United State Board of Tax Appeals

Notice of filing petition for review

Filed Sept. 14, 1936

To GUY T. HELVERING,
Commissioner of Internal Revenue, Washington, D. C.

Please Take Notice that the undersigned has today lodged with the United States Board of Tax Appeals, on behalf of the petitioner in the above-entitled case, a petition seeking a review of the Board's decision herein by the United States Circuit Court of Appeals for the Tenth Circuit. A copy of the Petition for Review and Assignments of Error as filed, is attached hereto and served upon you.

Dated the 14th day of September, 1936.

CHARLES B. MCINNIS,
Attorney for the Petitioner,
Transportation Building, Washington, D. C.

Receipt of the above and foregoing Notice, together with a copy of the Petition for Review and Assignments of Error mentioned herein, is hereby acknowledged this 14th day of Sept. 1936.

HERMAN OLIPHANT,
Attorney for Respondent on Review.

Before United States Board of Tax Appeals

Statement of evidence

Lodged Dec. 11, 1936. Filed Dec. 12, 1936

The above entitled cause came on for hearing before Honorable Herbert F. Seawell, Member of the United States Board of Tax Appeals at Washington, D. C., on January 31, 1935. The petitioner appeared by its attorneys Randolph E. Paul, Harold D. Roberts, and Charles B. McInnis, and the respondent appeared by his attorneys R. P. Hertzog, Conway N. Kitchen, and V. F. Weekley. Whereupon the following proceedings were had and the following evidence was received.

69 Stipulation of facts containing fifty-two numbered paragraphs and thirty-eight lettered exhibits was received in evidence. Subsequently a supplemental stipulation consisting of one typewritten page and later another second supplemental stipulation consisting of two typewritten pages and two lettered exhibits were received in evidence. That part of the stipulations and exhibits attached thereto bearing upon the issues involved in this cause is as follows:

Stipulation of facts

It is hereby stipulated by and between the above named petitioner and the Commissioner of Internal Revenue by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, that the following facts are true and that the Board may incorporate the same into its findings of fact subject to the right of either party to introduce additional evidence not inconsistent herewith:

1. Mountain Producers Corporation was organized on May 12, 1920, under the laws of the State of Delaware, and was at all times hereinafter mentioned a Delaware corporation with its principal office at 607 First National Bank Building, Denver, Colorado.

2. The Wyoming Associated Oil Corporation was organized on July 11, 1919, under the laws of the State of Delaware, and was at all times hereinafter mentioned a Delaware corporation with its principal office at 607 First National Bank Building, Denver, Colorado.

3. During and throughout the year 1925 the petitioner owned and held all the capital stock of Wyoming Associated Oil Corporation and was throughout said year affiliated in a Class A relationship with the Wyoming Associated Oil Corporation within the purview of Section 240 of the Revenue Act of 1926.

4. The petitioner and the Wyoming Associated Oil Corporation filed, for the year 1925, an affiliated income tax return on form 1120. For the purposes of computing the income tax liabilities of said corporations for the year 1925, the net income of the taxpayer should be computed, as in the deficiency letter of March 14, 1929, on a consolidated basis.

70 5. In the fall of 1909, William M. Fitzhugh, a mining engineer of San Francisco, entered into a mining partnership with a number of other individuals. The active field work of the above partnership was largely done by William M. Fitzhugh. It was financed and otherwise aided by the other members of the partnership. As among themselves the shares in the enterprise of the individual members were: William M. Fitzhugh, 1/8, Mary E. Fitzhugh, 1/8, and the remaining 6/8th distributed among other members of the partnership.

On behalf of this partnership titles and leases covering sundry parcels of land in the Salt Creek Oil Field in Natrona County, Wyoming, of the following classes or types, were acquired:

(a). Placer mining claims located under the Public Land Laws. These locations were recorded in the names of the various members of the partnership, using their names in rotation in groups of 8 names to each claim.

(b). Leases and operating agreements covering certain tracts of patented lands, principally a lease from the Stock Oil Company covering the east half of section 25-40-79 taken in the name of William M. Fitzhugh as lessee, but for the benefit of the partnership.

(c). A state oil and gas lease from the State of Wyoming covering Section 36-40-79 (sometimes referred to hereinafter as the "school" section land or "state school lease") running in the name of William M. Fitzhugh as lessee and held for the benefit of the partnership, which said lease is hereinafter referred to in paragraph 36.

* * * * * * *

6. On or about June 3, 1911, by a contract, a copy of which is attached hereto as Exhibit B, William M. Fitzhugh and Mary E. Fitzhugh transferred to the Midwest Oil Company, a corporation of the State of Arizona, their several undivided fractional interests in all the properties of said mining partnership described in paragraph 5 above.

7. On or about July 24, 1911, by a contract, a copy of which is attached hereto as Exhibit C, William G. Henshaw and the remaining members, other than the Fitzhughs, of said mining partner-
71 ship transferred their undivided interest in all of said properties to the Reed Investment Company, a corporation of the State of Colorado.

8. On or about July 14, 1911, the Midwest Oil Company and the Reed Investment Company, together with William M. Fitzhugh, entered into an agreement of partition, a copy of which is attached hereto marked Exhibit D.

* * * * * * *

10. The Reed Investment Company at this time was a closed

corporation transacting business in an informal manner, its stockholders falling into two groups known as (a) the "Majority Group," consisting of the late Verner Z. Reed, who owned a 64.125% interest therein, and (b) the "Minority Group," consisting of O. H. Shoup, B. H. Hopkins, the late K. C. Schuyler, J. L. Warran, A. M. Johnson, the late C. A. Fisher, and N. L. Wilson. The members of this group among them owned a 35.875% interest.

11. On or about May 10, 1912, when the Reed Investment Company had just completed payments to Henshaw and his associates of the purchase price of the lands referred to in paragraph 7 hereof, the said company and its individual stockholders caused 10 corporations to be organized having the following names, to-wit:

The Control Oil Company,
The Crescent Oil Company,
The Seattle Oil Company,
The Bluestone Oil Company,
The California Oil Company,
The Henshaw Oil Company.
The Fitzhugh Oil Company,
The Pinero Oil Company,
The Barbadoes Oil Company,
The Castle Creek Oil Company.

Thereupon the Reed Investment Company, acting through O. H. Shoup, made to each of said companies (except the Henshaw Oil Company and the Castle Creek Oil Company later herein separately dealt with) a proposal to transfer property to said corporations which in each case was accepted by the company addressed therein.

Immediately thereafter legal title to the property described in
72 each such proposal was conveyed by the Reed Investment Company to the company addressed. These proposals and acceptances are identical in form. * * * Copies of the proposal and acceptance addressed to and executed by the California Oil Company (which include reference to Section 36) are also attached hereto as Exhibit H and I.

12. On or about May 26, 1915, by which time certain transfers of the fraction owned by Verner Z. Reed had occurred, each of said companies (except the Henshaw Oil Company and the Castle Creek Oil Company) executed, pursuant to appropriate corporate action, formal declarations of trust to evidence the title situation resulting from the proposal and acceptance referred to herein. The declaration of trust executed by the Pinero Oil Company, which is in form identical with all the others, is attached hereto as Exhibit J.

13. In the case of the exceptions noted in paragraph 12, the Henshaw Oil Company received from the Reed Investment Company an outright assignment covering certain placer locations on the extreme edge of the field. These were regarded as having only speculative value and were, for the most part, surrendered or lost in subsequent title controversies. No part of the school section and no lands of substantial value in the central parts of the field went to the

Henshaw Oil Company. The Castle Creek Oil Company received only an undivided one-half interest in the lease covering the "Iba 80" referred to above. (Paragraph 9 referring to "Iba 80" omitted because not material to the issues in this cause.)

14. The stock of the Little Reed Companies, including the stock of the Castle Creek Oil Company and the Henshaw Oil Company, was owned by members of the Majority Group and members of the Minority Group in percentages respectively of 64.125% and 35.875%. Individually the stockholders of the 10 Little Reed Companies were the same as the stockholders of the Reed Investment Company and held their stock in the same proportions.

* * * * * * *

16. On or about February 2, 1914, Verner Z. Reed transferred a beneficial interest in a 5% interest in all said properties, being a part of his 64.125% interest therein, to his daughter, Margery V.
73 Reed. This was accomplished by a declaration of trust in which Verner Z. Reed was himself trustee for Margery V. Reed to the extent of this 5%. Subsequently, The Equitable Trust Company of New York succeeded Verner Z. Reed as such trustee, and recognized Margery V. Reed as its direct beneficiary.

17. On or about February 2, 1914, Verner Z. Reed transferred a beneficial interest in a 5% interest in all said properties, being a part of his 64.125% interest therein, to his son, Verner Z. Reed. This was accomplished by a declaration of trust in which Verner Z. Reed was himself trustee for Verner Z. Reed, Jr., to the extent of this 5%. Subsequently, The Equitable Trust Company of New York succeeded Verner Z. Reed as such trustee, and recognized Verner Z. Reed, Jr., as its direct beneficiary.

18. On or about February 2, 1914, Verner Z. Reed transferred a beneficial interest in a 5% interest in all said properties, being a part of his 64.125% interest therein, to his son, Joseph V. Reed. This was accomplished by a declaration of trust in which Verner Z. Reed was himself trustee for Joseph V. Reed to the extent of this 5%. Subsequently, The Equitable Trust Company of New York succeeded Verner Z. Reed as such trustee, and recognized Joseph V. Reed as its direct beneficiary.

19. On or about April 3, 1914, Verner Z. Reed gave absolutely, and pursuant to said gift transferred to his wife, Mary Dean Reed, a 5% interest in all said properties, being a part of the 64.125% interest originally held by said Verner Z. Reed. All of the transfers referred to in paragraphs 16, 17, 18, and 19 hereof, are referred to and recognized in the declarations of trust dated May 26, 1915, one of which is attached hereto as Exhibit J.

20. On July 10, 1916, said Verner Z. Reed disposed of an additional 9% interest in said lands out of the 44.125% remaining to him, transferring this 9% interest to The Equitable Trust Company of New York under a certain Trust No. 1 in favor of sundry beneficiaries.

21. On July 10, 1916, said Verner Z. Reed disposed of an additional 9% interest in said lands out of the 44.125% remaining to him, transferring this 9% interest to The Equitable Trust Company of New York under a certain Trust No. 2 in favor of sundry beneficiaries.

74 22. The said Verner Z. Reed died on April 20, 1919, at which date he still owned 26.125% in said lands and leases, being that part of said original 64.125% interest still retained by him after the transfers described in paragraphs 16, 17, 18, 19, 20, and 21 hereof. A copy of the will of said Verner Z. Reed, which was duly admitted to probate, is attached hereto as Exhibit K.

* * * * * * * *

24. On or about October 3, 1917, the members of the Minority Group transferred and assigned their several interests in said lands and leases, aggregating 35.875% thereof, to the Midwest Refining Company, a corporation of the State of Maine, and in exchange therefor received in the aggregate 11,402 shares of the capital stock of the Midwest Refining Company, this stock being apportioned among the several members of the Minority Group in the proportion of their respective fractions thereof.

25. In January 1919 the Midwest Refining Company transferred it' said 35.875% interest in said properties to Salt Creek Producers Association, Inc., a Virginia corporation. At this same time the Midwest Refining Company also transferred to Salt Creek Producers Association, Inc., certain so-called adverse or conflicting titles derived from Frank Curtis, B. D. Townsend and Fred Lobell and others, affecting or conflicting with titles of many tracts of land in the Salt Creek Field, including the lands and leases then held by the 10 Little Reed Companies named in paragraph 11 hereof and the several beneficiaries for whom said companies acted as trustees. The Salt Creek Producers Association, Inc., in exchange for all of these properties and interests, and in exchange for certain outstanding notes theretofore executed by the Midwest Oil Company payable to the Midwest Refining Company in the principal amount of $1,630,000, issued 305,360 shares of its stock to the Midwest Refining Company.

* * * * * * * *

27. The Wyoming Associated Oil Corporation was organized under the laws of the State of Delaware on July 11th, 1919, an extract from the minutes of a special meeting of the Board of Directors of the Wyoming Associated Oil Corporation held July 18, 1919, being attached hereto as Exhibit L-1. Immediately after the organiza-

75 **tion of the Wyoming Associated Oil Corporation, the corporation received deeds, assignments and conveyances executed by:**

(a) The members of the Majority Group, being the Executor of the Estate of Verner Z. Reed, deceased, Mary Dean Reed, and The Equitable Trust Company of New York, acting at the request and with the concurrence of its several beneficiaries, to-wit: Margery

V. Reed, Verner Z. Reed, Jr., Joseph V. Reed, the beneficiaries of Trust No. 1, and the beneficiaries of Trust No. 2;

(b) The Minority Group, being now Salt Creek Producers Association, Inc., as successor in interest of the original individual members;

(c) The 10 Little Reed Companies named in paragraph 11 hereof as holders of legal title and as trustees for the members of the Majority and Minority Groups; and

(d) Salt Creek Producers Association, Inc., as owner of sundry adverse and conflicting claims to title referred to in paragraph 25 hereof.

* * * (Pertinent portions of said deeds, assignments, and conveyances are attached hereto as Exhibit L–2.)

28. At the time of or immediately after its organization, the Wyoming Associated Oil Corporation issued its total authorized capital stock consisting of 350,000 shares having no par value. Of said 250,000 shares, 50,000 shares were issued for the conflicting or adverse titles derived through Salt Creek Producers Association, Inc., as stated in paragraph 25. The balance, or remaining 300,000 shares, were issued to the owners of the members of the majority and minority groups in proportion to their respective interests in the Little Reed Companies as hereinabove set forth. The transaction involving the issuance of the 300,000 shares of stock of the Wyoming Associated Oil Corporation to the stockholders of the 10 Little Reed Companies was treated by the Commissioner of Internal Revenue as a non-taxable reorganization within the meaning of Section 202 of the Revenue Act of 1918 and has been treated as such by the 10 Little Reed Companies and all of their stockholders.

29. The issuance of the 50,000 shares of stock by the Wyoming Associated Oil Corporation to Salt Creek Producers Associa-
76 tion, Inc., for adverse or conflicting titles, has been recognized by the Commissioner of Internal Revenue as a taxable transaction, and Salt Creek Producers Association, Inc., has paid income and profits taxes on and with respect thereto.

30. On February 25, 1920, an act of Congress, known as the Oil and Gas Leasing Act, went into effect. Under its so-called relief provisions, particularly those set forth in Sections 18, 18 (a) and 19 of said Act, the located lands acquired by the Wyoming Associated Oil Corporation in the manner outlined above, became eligible for exchange into government leases, and, pursuant to said Act, in the years 1920 and 1921, the Wyoming Associated Oil Corporation received from the United States, in lieu of its former placer mining locations, leases covering the lands listed by governmental subdivisions under the caption "United States Government Leases" in Exhibit O–1. * * * (Exhibit O–1 omitted because not material to the issues in this cause.)

31. On or about February 1, 1923, the Wyoming Associated Oil Corporation exchanged certain of the lands and leases then owned and held by it for certain other lands and leases then held by the

Midwest Oil Company and by the Wyoming Oil Fields Company in the Salt Creek Field. This exchange resulted in consolidating the leaseholds of each of the companies party thereto into more compact blocks with a decrease of the necessity for offset drilling.

32. On the same date, February 1, 1923, the Wyoming Associated Oil Corporation and the Midwest Oil Company executed an instrument dated February 1, 1923, a copy of which is attached hereto as Exhibit N, which said instrument continued in force and effect throughout the taxable year 1925.

* * * * * * *

35. On or about February 1, 1923, the Wyoming Associated Oil Corporation, the Midwest Oil Company, and the Wyoming Oil Fields Company entered into a contract with the Midwest Refining Company, a true copy of said contract being attached hereto as Exhibit T–1. On the same date, February 1, 1923, the Wyoming Associated Oil Corporation and the Midwest Refining Company entered into a contract, a true copy of said contract being attached hereto as Exhibit T–2.

77 36. On or about April 19, 1923, the State of Wyoming entered into a lease agreement, a true copy of which is attached hereto as Exhibit U–1, which lease agreement was a renewal of a previous agreement dated October 1, 1919, a true copy of which is attached hereto as Exhibit U–2. The said agreement dated October 1, 1919, was a renewal of a previous agreement dated December 26, 1914, a true copy of which is attached hereto as Exhibit U–3, which said agreement dated December 26, 1914, was a renewal of a previous agreement dated January 4, 1910, a true copy of which is attached hereto as Exhibit U–4.

37. If the Board should find that the amount of $185,438.83 added in Item (d) to taxable income in the deficiency notice is exempt from taxation, then the deductions allowed in the deficiency letter should be reduced in the amount of $45,927.12 reperesenting the depletion applicable to this income, and in the amount of $5,602.81 and $18,431.11, representing taxes and royalties which were allowed as deductions in the deficiency notice.

38. Attached hereto as Exhibit V is a statement showing for the year 1925 the following:

(a) The production in barrels from the properties listed therein.

(b) The income received by the Wyoming Associated Oil Corporation allocated by tracts, at the price stated in the contracts referred to in paragraph 35 of this stipulation.

(c) The general and overhead expense of the Wyoming Associated Oil Corporation allocated to the tracts included in the said list.

(d) The net income of the Wyoming Associated Oil Corporation allocated to the same tracts.

(e) The field operating expense of the Midwest Refining Company under the contracts referred to in paragraph 35 of this stipulation, allocated to the same tracts.

The average field price of oil or market price of oil in the Salt Creek Field, Wyoming, during the year 1925, was $1.808605 per barrel.

39. The consolidated return filed by the Mountain Producers
78 Corporation and the Wyoming Associated Oil Corporation for the year 1925, which was on the accrual basis, did not include in Items 1 to 10 thereof as income any amount which was expended by the Midwest Refining Company in accordance with the contracts referred to in paragraph 35. None of such amounts were entered as income on the books of the Wyoming Associated Oil Corporation or the Mountain Producers Corporation. Said return included in gross income (Item 4a) the net prices actually received pursuant to said contracts. The said return computed depletion, in so far as depletion consisted of 27½% of the gross income from the property, by taking 27½% of an amount consisting of the barrels of oil produced from the properties of the company at the market price of oil in the field at the date of production.

* * * * * * *

52. Any statements contained in the text of this stipulation concerning the nature of the interest of the Wyoming Associated Oil Corporation and its predecessors from time to time in the State School Section, 36-30-79, and the production therefrom and income relating thereto, shall be taken as convenient words of description only, and not as fixing or defining the classification or nature of such interest at any point, or during any period of time. For all purposes of classification and definition of such interest, the pertinent documents themselves and the primary facts as established by all the evidence, including this stipulation, shall govern.

Thereupon, Henry C. Wadlington, having been first duly sworn as a witness on behalf of the petitioner, testified as follows:

DIRECT EXAMINATION

I am General Auditor of the Wyoming Associated Oil Corporation and also hold the same position with the Midwest Oil Company. I have been continuously in the employ of both corporations since February 1, 1923. I am familiar with the oil and gas lease from the State of Wyoming to the Midwest Oil Company, dates April 19, 1923, attached as Exhibit U-1 to the Stipulation of Facts, and I am also familiar with the operations under that lease. Throughout the year 1925 and at all times during the period from 1924 until 1934 the royalties payable to the State of Wyoming under the said lease were paid to the State of Wyoming by oil in kind.

79 I am familiar with the method of settlement between the Midwest Oil Company, the Wyoming Oil Fields Company, and the Wyoming Associated Oil Corporation, referred to as the "producing companies" and the Midwest Refining Company, referred to as the "refining company" under Article III of the Agreement between the above-mentioned parties, dated February 1, 1923, and

included as Exhibit T–1 in the Stipulation of Facts. Settlement was made by the Midwest Refining Company with each of the producing companies in separate remittance papers detailing the proceeds from the sale of oil produced from each tract. Royalties payable in kind were divided at the pipeline and payment was made to the three producing companies for their share of the oil after the royalties in kind had been paid. With respect to royalties payable in cash, the refining company would deliver to the respective producing company the total amount of cash payable for the oil produced from its properties and the particular producing company would, in turn, pay its own cash royalties. The same practice prevailed with respect to the operations under the contract attached to the Stipulation of Facts as Exhibit T–2, and the lands covered thereby.

With respect to the operation of Section 36, the oil produced from that section by the refining company was first collected into battery tanks where it was steamed and the impurities taken out. The Wyoming Associated Oil Corporation has a man employed at the battery tanks to gauge the oil as it is delivered to the gathering lines of the pipeline company. From the battery tanks, the State of Wyoming's share of the oil is delivered to its representative and the balance of the oil is divided equally between the Wyoming Associated Oil Corporation and the Midwest Oil Company. The representative of the Wyoming Associated Oil Corporation checks the gauging of the oil, supervises the run from the battery tanks into the large collecting tank for the entire field, signs the run checks for the Wyoming Associated Oil Corporation's share and forwards them to the home office of the corporation at Denver.

CROSS EXAMINATION

The Midwest Refining Company actually carries on the operations of the properties of the Wyoming Associated Oil Corporation as agent for the latter company, including Section 36
80 as well as the other leases. The Wyoming Associated Oil Corporation has a representative on the field at all times looking after its interest with particular reference to possible economies in operation. He reports to the Denver office of the Wyoming Associated Oil Corporation all matters concerning the operations of the Company, which, in his opinion, affect the interest of the latter corporation. The officials of the latter corporation take up with officials of the Midwest Refining Company from time to time various matters affecting the operations in the field. (Witness excused.)

Thereupon, Harold D. Roberts having been first duly sworn as a witness on behalf of the petitioner, testified as follows:

DIRECT EXAMINATION

I am an attorney of the State of Colorado, having been admitted to the bar of that State either in 1916 or 1917, and I am at present a

member of the law firm of Dines, Dines and Holme, which firm is General Counsel for the Wyoming Associated Oil Corporation. In apportioning our work in the firm among the various members, it fell to my part to give my particular attention to the oil company work, including the work of the Wyoming Associated Oil Corporation. Dating back to about 1917, I became quite active in litigation of that Company over titles in the Salt Creek Field and have been continuously familiar with these titles and executive affairs from that date to the present time. At the time of the passage of the Leasing Act, I had charge of converting its placer rights into Government leases and so became very familiar with its title lines in that work.

I am also familiar with the operations in the Salt Creek Field as it is part of my duty to go to the field and see the operations on the ground from time to time. I make at least one trip to the field most years and sometimes three or four trips a year.

I drafted the declaration of trust executed by the Midwest Oil Company February 1, 1923, and attached as Exhibit N to the Stipulation of Facts. This instrument was drawn at the time that the Wyoming Associated Oil Corporation's interest in the State lease on Section 36 changed from a segregated or from a complete interest in a segregated 400 acres of the Section to an un-
81 divided 50% interest in the lease on that section. The purpose of this instrument was to show the undivided 50% interest that obtained from that date forward. The preceding definition of interest in favor of the Wyoming Associated Oil Corporation, referred to in the declaration of trust, is set forth in an agreement dated July 14, 1911, between William M. Fitzhugh, the Midwest Oil Company, and the Reed Investment Company attached to the Stipulation of Facts as Exhibit D. That instrument, executed in advance of the acquisition by the Reed Investment Company of the Henshaw interests in the State School lease, fixed the lines of a partition to become effective upon the acquisition of the Henshaw interests by the Reed Investment Company, and fixed that interest as a segregated 400 acres of land in that section. The purchase contemplated by Exhibit D of the Stipulation of Facts took place with the result that that instrument served to define the interests in that section of the Wyoming Associated Oil Corporation, because it defined the interest in that section of its predecessor in title or interest.

The declaration of trust (Exhibit N of the Stipulation of Facts) was drawn on February 1, 1923, when that segregated interest changed to an undivided interest. So far as I know, there were no executed formal documents dealing with Wyoming Associated Oil Corporation's interest in that section, between the dates July 14, 1911, and February 1, 1923, although the fact of that segregation of 400 acres to the Wyoming Associated Oil Corporation or its predecessors is incidentally referred to in title lists in a great many

documents. I was personally acquainted with William G. Henshaw and am familiar with his signature. I recognize his signature on that document (document handed witness for identification) which he has signed personally and as attorney in fact. This document came from the title files of the Wyoming Associated Oil Corporation, and I have been familiar with it in the title files of the so-called Little Companies which preceded the Wyoming Associated Oil Corporation. This is one of the deeds that carried out the purchase of the Henshaw interests by the Reed Investment Company, which purchase was forecast in the document attached as Exhibit D to the Stipulation of Facts. This document is likewise referred to in Exhibit C attached to the Stipulation of Facts. This deed was placed in escrow until the purchase price referred to in Exhibit C of
82 the Stipulation of Facts was paid and was then delivered. Thereupon, the document was offered and received in evidence and marked Exhibit No. 1.

The witness called attention to a typographical error in the description of Section 36 in the said document. The township referred to in the second paragraph, 7th line from the top of page 2 is "79" instead of "97." The reference to the correct township is established by Exhibit C of the Stipulation of Facts and by numerous other documents.

The right of election given the producing companies in paragraphs A, B and C of Section 1, Article I of the two agreements, dated February 1, 1923, and attached to the Stipulation of Facts as Exhibits T–1 and T–2 respectively, was exercised by the Wyoming Associated Oil Corporation by selecting the sliding scale of prices outlined in paragraph A of the said Section 1 of the two agreements rather than the schedule of prices outlined in paragraph B of Section 1 of the two agreements.

Disputes have arisen between the Wyoming Associated Oil Corporation and the Midwest Refining Company over the interpretation of Section 2, Article III of the two agreements, dated February 1, 1923 (Exhibits T–1 and T–2 of the Stipulation of Facts). One of the disputes arose as a result of a small fire on the leased premises and involved a question of who should bear the loss of oil resulting from the fire. The dispute was settled on the basis of the strict language of the contract. If the loss occurred prior to the passage of the oil through the tail gate on the measuring tank, it would fall on the producing company but if the loss occurred after the oil had passed that point, the loss would fall on the refining company and the producing company would be paid the full price for the oil in question. Another dispute arose between the Wyoming Associated Oil Corporation and the Midwest Refining Company with respect to the deduction of 3% for moisture and basic sludge covered by the same section of the two contracts. Within a year or two after the execution of the contracts, the executives of the Wyoming Associated Oil Corporation made a very strong request for a reduction of the

3% allowance for moisture and basic sludge and succeeded in getting the refining company to make a uniform rule of 2% deduction instead of the 3% deduction named in the contract. The 2% deduction remained in effect until a later date when the Federal Gov-
83 ernment, which is the landlord in the Federal leases in the field, made a demand for full 100% measurement with deduction only for actual impurities. When the Federal Government succeeded in that position, the executives of the Wyoming Associated Oil Corporation insisted upon the application of that rule under the two contracts. That rule was subsequently put into effect in Section 36 at the demand of the State of Wyoming.

The question of the degree of temperature to be used as a standard for the purpose of measuring the oil was likewise the subject of active discussions between the officials of the Wyoming Associated Oil Corporation and officers of the refining company. Eventually it was decided that the temperature should be corrected to 60 degrees fahrenheit as a standard temperature for measuring the oil.

Acting under the authority given it by Section 5, Article III, of the two contracts, the Wyoming Associated Oil Corporation maintained a full time employee in the field for the purpose of checking the performance of the Midwest Refining Company under the said contracts. The duties of the Wyoming Associated Oil Corporation's representative in the field were to measure the oil in the measuring tanks before it was delivered to the pipeline, to countersign all run checks showing the amount of oil delivered to the pipeline, to observe conditions at the wells, to check all drilling in the field and to report any facts which, in his opinion, indicated that the Midwest Refining Company was not living up to the two contracts of February 1, 1923. His duties included the gauging and inspection of the wells on Section 36 along with the wells on the other leases owned by the Wyoming Associated Oil Corporation.

A great many discussions took place between officials of the Wyoming Associated Oil Corporation and the Midwest Refining Company under Section 6, Article III, of the two contracts of February 1, 1923, the arbitration clauses, with respect to proration in the Salt Creek Field. Likewise a number of discussions occurred under those clauses with respect to the substitution of electrical power for gas or oil burning engines for pumping the oil and also with respect to introducing gas into the wells in order to stimulate production.

The lease from the State of Wyoming, dated April 19, 1923,
84 covering Section 36 (Stipulation of Facts, Exhibit U–1) expired on October 1, 1929, and was followed by another lease between the same parties, dated October 22, 1929, which expired December 22, 1934. The latter lease was, in turn, followed by another one covering the same section, dated December 22, 1934. I conducted most of the negotiations leading up to the last mentioned lease and was present at several of the conferences. In the course of these negotiations, the Wyoming Associated Oil Corporation received a formal letter

from the Commissioner of Public Lands of Wyoming advising that the lease would be granted. That is the letter to which I refer (witness indicating letter). It is signed by Mr. Fitzpatrick, whom I know and with whom I have conducted official business with the State of Wyoming for three or four years.

Thereupon, the letter in question was offered in evidence by counsel for the petitioner. Objection was made by counsel for the respondent, which objection was sustained by the Member.

I was present at a conference between representatives of the State of Wyoming and representatives of the Wyoming Associated Oil Corporation relative to the leasing of Section 36 shortly before the lease of April 29, 1923 (Stipulation of Facts, Exhibit U–1, was made. The conference was presided over by Governor Ross of the Wyoming State Land Board. In addition to the Governor Ross, Mrs. Martin, Superintendent of Public Instruction of the State of Wyoming and two or three other members of the Board, whose names I cannot recall, were present. Mr. Barnett, President of the Wyoming Associated Oil Corporation and I were present on behalf of that company and there were other people present. It was in the nature of a public hearing and discussion conducted at Cheyenne, Wyoming, in the early part of April 1923.

Thereupon, counsel for the petitioner propounded the following question which was objected to by counsel for the respondent: "Q. Will you state all that you can remember occurring at that conference?"

After some discussion the Member agreed to let the witness answer the question and then let counsel for respondent move to strike it.

Whereupon, the question was answered as follows:

85 I can only fix the date of the conference from the date of the lease that resulted from it. The lease is dated April 19, 1923. I remember that it was rather cold wintry weather and in the normal course of events would be a month or six weeks before the actual date of the lease that resulted from it. The conference or hearing was brought about by the Land Board of the State of Wyoming, calling for a renewal of the lease on Section 36 some 18 months in advance of the expiration date of the then existing lease. The then existing lease is Exhibit U–2 attached to the Stipulation of Facts. That lease would not have expired until October 1, 1924, but the State Land Board had invited proposals for a renewal of the lease some 18 months in advance of its expiration date.

The Wyoming Associated Oil Corporation, through Mr. Barnett, took part in that hearing and objected to that procedure inasmuch as it would have the effect of forcing the Wyoming Associated Oil Corporation, as well as the Midwest Oil Company, to bid higher royalties than they might have had to meet if the matter had been permitted to wait until a time nearer the expiration date of the lease. Mr. Barnett, as I recall, made something of an argument before the State Land Board. I do not recall whether I made one or not, but I

was there. The net result was that the State Land Board did just what they intended to do in the first place, forced us to put in an application for a lease if we wanted it, and the result was uniformly raising the royalty from 33⅓% to the uniformly higher royalty of 65%. The higher royalty was provided for in the new lease (Stipulation of Facts, Exhibit U–1) which did not take effect until after the end of the then existing lease although it had been negotiated and signed a year and a half in advance of the expiration of the then existing lease.

Thereupon, counsel for the respondent again objected to the question and moved that the answer be stricken for the reason that it is incompetent, irrelevant, and immaterial and an attempt to alter or vary the terms of a written instrument, a copy of which was attached to the Stipulation of Facts as Exhibit U–1. This motion
86 to strike the answer was allowed by the Board and counsel for petitioner noted and was allowed an exception.

Thereupon the following question was propounded to the witness by counsel for the petitioner: "Q. Were you present at any conference in September 1929 between representatives of the Midwest Oil Company, the Wyoming Associated Oil Corporation, and the State of Wyoming"? The above question was objected to by counsel for the respondent and the objection was sustained. Whereupon the counsel for the petitioner noted and was allowed an exception.

CROSS EXAMINATION

I am familiar with the manner in which payments were made to the State of Wyoming of its royalties under Section 36. These payments were made during the year 1925 by oil in kind which was delivered to the State of Wyoming or its nominee. The oil was delivered directly from the measuring tank to the common carrier that received it on behalf of the purchaser from the State. There was no money settlement between either the Midwest Oil Company or the Wyoming Associated Oil Corporation and the State of Wyoming. The State's royalty oil was purchased during the year 1925 by either the White Eagle or the Empire Oil and the State was paid directly by the purchaser for its share of the oil produced from Section 36. (Witness excused.)

Thereupon, counsel for the petitioner offered in evidence an abatement claim, filed by the Wyoming Associated Oil Corporation with the Collector of Internal Revenue at Denver, Colorado, under date of August 30, 1923, covering the period January 1, 1922, to December 31, 1922, in which claim the Wyoming Associated Oil Corporation contended that its share of the income received from Section 36 was exempt from Federal taxation. Said claim was offered by counsel for petitioner for the purpose of showing that the officials of the Wyoming Associated Oil Corporation had the question of exemption in mind at or about the date on which the lease of April 19, 1923 (Stipulation of Facts, Exhibit U–1) was made. Counsel for respond-

ent objected to the introduction of the claim and the objection was sustained by the Member. Counsel for the petitioner noted and was granted an exception.

87 Thereupon counsel for the petitioner offered in evidence another abatement claim filed by the Wyoming Associated Oil Corporation with the Collector of Internal Revenue at Denver, Colorado, May 27, 1922, which claim also contains the claim of exemption with respect to the proceeds of oil from Section 36.

Counsel for respondent objected and the objection was sustained, whereupon counsel for the petitioner noted and was granted an exception.

Thereupon both parties rested their case.

Stipulation re statement of evidence

The parties to this proceeding agree that the foregoing is all of the material evidence adduced at the hearing before the United States Board of Tax Appeals bearing upon the issues raised in the Petition for Review, and consent is hereby given to an order being entered by the United States Board of Tax Appeals approving the same.

RANDOLPH E. PAUL,
CHARLES B. MCINNIS,
Attorneys for the Petitioner,
Transportation Building, Washington, D. C.
MORRISON SHAFROTH,
Counsel for the Respondent.

Order approving statement of evidence

The foregoing Statement of Evidence sets forth all of the material evidence adduced at the hearing of this cause bearing upon the issues raised in the Petition for Review, and, in order that the same may be preserved and made a part of this record, said Statement of Evidence is duly approved, settled, and ordered filed this 12th day of December 1936.

(s) EUGENE BLACK, *Member,*
United States Board of Tax Appeals.

Exhibit B

This Contract made and entered into this 3rd day of June, 1911, by and between William M. Fitzhugh, party of the first part,

88 and the Midwest Oil Company, hereinafter called the "Oil Company," party of the second part, and O. H. Shoup, party of the third part, Witnesseth:

That Whereas on even date herewith said Fitzhugh has made, executed, and delivered a quit claim deed to the party of the third part to be held by the party of the third part for the benefit of the party of the second part, and there will shortly be executed and delivered to said O. H. Shoup a deed by the wife of said Fitzhugh, also con-

veying all her right, title, and interest in the same property to be held for the benefit of the second party; and,

Whereas, the said Fitzhugh has on even date herewith made, executed, and delivered an assignment to the Oil Company of all his right, title, and interest in that certain agreement made and entered into on November 27th, 1909, between Stock Oil Company and the said Fitzhugh, and also all his right, title, and interest in that certain lease to said Fitzhugh from the State of Wyoming, dated January 4th, 1910; and,

Whereas, William G. Henshaw, of San Francisco, California, makes, or has made certain claims of interest in said property, and it is the intention of the said grantors in said deeds and assignments, therefore, simply to convey what interest they have in said property to the interests of said Henshaw whatever they may be and as they have, and as such interests may hereafter appear without derogation to the interests of sair Henshaw whatever they may be and as they shall hereafter appear.

Now, Therefore, In consideration of the premises and of the faithful performance of the terms and conditions hereinafter set forth, and of one dollar and other good and valuable considerations, in hand paid said Fitzhugh, the receipt of which is hereby confessed and acknowledged, the said Fitzhugh and the other parties have agreed, and do hereby agree with each other as follows, to-wit:

1. The interest conveyed by said grantors in and to what are known as located lands, specified in said conveyances (a copy of one of which, describing the property, is hereunto attached), not including therein the lands described in the agreement with the Stock Oil Company, or in the said lease from the State of Wyoming amounts in the aggregate to not less than an undivided two-eighths interest in said property.

89 2. The said party of the third part agrees that he will hold the title to the interest in lands so conveyed to him, solely for the benefit of the Oil Company and upon demand of the Oil Company will convey said premises to said Oil Company; and without the consent of said Fitzhugh will convey said premises to no other person, association or corporation, save and except the said Oil Company; and that while he holds title to the lands in his name they shall be subject to the sole use of the Oil Company for the purpose of enabling it to comply with the terms and conditions of this agreement, except that said lands may be subjected to rights of way for oil pipe lines.

3. The Oil Company will immediately proceed to endeavor to secure a settlement with Henshaw of the respective interests of Shoup and Henshaw in the lands described in said conveyances, agreement, and lease, and, if possible, to secure a partition of lands according to said respective interests. No settlement or partition of said lands or of interests under said agreement or said lease shall be made which results in less than twenty-five per cent of said lands being parti-

tioned or set aside to said Shoup, unless said Fitzhugh and the Oil Company agree to settlement under a less amount; if said Oil Company can secure a settlement or partition on the basis of twenty-five per cent interest therein for said Shoup, then if said Fitzhugh so desires, said settlement and partition shall be accepted; if necessary, suit or suits shall be brought by the Oil Company to effect partition; the Oil Company paying all of the expense of conducting litigation, partition, and settlement proceedings; this does not include any obligation to pay any purchase price.

4. When such settlement or partition has been made the Oil Company shall for its services receive the right to take for its own use one-third of all the oil contained in said lands without any other charge or expense to it; and two-thirds of the oil in said lands shall be the property of said Fitzhugh. As to located lands, the Oil Company shall perform the annual assessment work necessary to maintain possessory title thereto under the laws of the United States; or may contribute the proportion of the expense of said work proportionately with others claiming ownership therein; but with or without contribution shall see that such assessment work is done.

90 This section applies to located lands on which discoveries have been made. Two-thirds of the expense of such assessment work shall be charged against the account of such Fitzhugh to be paid out of the amount to become due to him upon the purchase of said oil as hereinafter set forth.

5. Said Fitzhugh at the request of the Oil Company shall do and perform all things which the Oil Company requests him to do in the way of co-operating toward the making of such settlement or partition, and toward perfecting and maintaining title to the interests in said property so conveyed; but said Company shall have charge of all such matters and said Fitzhugh shall, so far as he participates therein, do so only under the directions of the Oil Company, but said Fitzhugh shall be at all times consulted about and kept advised concerning the progress of negotiations or litigation.

6. After partition or settlement of the lands has been effected fifty per cent of all oil handled through the pipe line or pipe lines of the Oil Company shall be taken from said lands so segregated or partitioned; if such lands are capable of producing oil up to that amount; two-thirds of said fifty per cent so handled to be the property of Fitzhugh and one-third to be the property of the Company; if Fitzhugh at any time is dissatisfied with the amount of development being done to produce oil he shall have the right at his own expense to enter upon the lands so segregated and sink wells, paying all the costs thereof; after which the Oil Company shall apply its pumps thereto for the purpose of producing oil therefrom.

7. For the said Fitzhugh oil at all times when the price of crude oil, f. o. b. Casper, is sixty-two and one-half cents or greater; he shall be paid thirty-seven and one-half cents per barrel; and when said price of crude oil is less than sixty-two and one-half cents per barrel,

f. o. b. Casper, then for said Fitzhugh oil he shall be paid by the Oil Company sixty per cent of the price received, and the Oil Company shall receive forty per cent for its cost of production and carriage; the price of sixty-two and one-half cents is composed of thirty-seven and one-half cents payment to Fitzhugh per barrel; twenty cents pipe line charge, and five cents cost of production to the Company, and the prices received less than sixty-two and one-half cents per barrel are to be divided as aforesaid, sixty per cent to Fitzhugh as payment for his oil and forty per cent to the
91 Company as payment for its transportation and cost of production. Whenever said oil is taken from ground that is leased, Fitzhugh shall pay two-thirds of the royalty accruing to the lessors and the Company one-third.

8. The Oil Company shall have the right to use the oil free of charge so far as needed for fuel in connection with production of said oil or for use in the pumping plant in pumping the proportion of oil so to be paid for to said Fitzhugh.

9. The Oil Company shall pay Fitzhugh One Thousand Dollars a month, the first payment to be made at the time of executing this contract and One Thousand on or before the 5th day of each month hereafter succeeding for ten months, or until a total of Ten Thousand Dollars has been so paid to said Fitzhugh; the amount so paid shall be charged against Fitzhugh's account as advance payments upon oil hereafter to be handled and paid for to him as hereinabove provided.

10. If for any reason the assignment of the lease from the State of Wyoming is not accepted by the State, so that the legal title thereto must remain in the name of said Fitzhugh, then this contract shall apply to him as to that tract of land, as Trustee, and he shall hold the same under such circumstances as Trustee, for the sole use and benefit of the Oil Company.

11. After said lands have been segregated, the Oil Company shall proceed diligently in the work of developing the same for oil with the object of enabling production therefrom of oil in a quantity up to fifty per cent of the amount actually being handled from the field through its said pipe line or pipe lines; but it shall not be required nor the said Fitzhugh permitted to produce oil from said lands in excess of said amount; and the Oil Company shall have the sole and exclusive right to purchase two-thirds of the fifty per cent of the oil so handled at the price and upon the terms of Paragraph 7 set forth; settlement for the oil so to be purchased from said Fitzhugh during any one month shall be made by the Oil Company to Fitzhugh on or before the tenth day of the month succeeding that in which said oil is so purchased.

12. The oil produced from the segregated property shall be
92 pumped into a separate tank or tanks by the Oil Company and there measured before being transported from the district or mixed with any other oil; and the oil actually being handled through

the pipe line or pipe lines of the Company shall likewise be measured; and said Fitzhugh shall have the right at any and all times by himself or his agents, to inspect the amount of oil produced from such segregated lands and to measure and check measurements of oil produced therefrom, and to inspect the reports of said Oil Company so far as they pertain to or in any way cover or affect the oil production in said Salt Creek District, said District being the territory from which the oil handled by the pipe line or pipe lines—fifty per cent of which amount handled is affected by this contract—is produced.

This contract shall be binding upon and extend to the heirs, executors, administrators, successors, and assigns of the respective parties; the obligation of the party of the third part hereunder being exclusively set forth in Paragraph 2 hereof.

In Witness Whereof the individual parties hereto have hereunto set their hands and seals and The Midwest Oil Company has caused these presents to be executed in its corporate name, by its officers thereunto duly authorized, the day and year first hereinabove written.

WILLIAM M. FITZHUGH, [SEAL].
O. H. SHOUP, [SEAL]
THE MIDWEST OIL COMPANY,
By O. H. SHOUP, *President.*

[SEAL OF MIDWEST OIL CO.]
Witnesses as to Fitzhugh and Shoup:

K. C. SCHUYLER.
J. L. WARREN.

(Verifications attached.)

Exhibit C

This Memorandum of Agreement, made and entered into this 24th day of July 1911, by and between Wm. G. Henshaw, Hetty T. Henshaw, Helen W. Henshaw, Tyler Henshaw, Alla S. Chickering, Henry D. Nichols, Ethel K. Nichols, E. M. Hall, Lillie T. Hall, F. W Henshaw, H. J. Knowles, W. H. Metcalf, A. H. Chickering, C. T. Rudolph, Emil Nuesbaumer, P. C. Black, and Harry Chickering, all of the State of California, parties of the first part, and O. H. Shoup, trustee, of the county of El Paso, State of Colorado, party of the second part, Witnesseth, That,

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Whereas, The parties of the first part are the owners of certain interests in various located oil placer mining claims, and of interests in leases and agreements upon and affecting located and patented oil-bearing lands in the Salt Creek Oil Fields, in Natrona County, State of Wyoming, and particularly in a certain lease upon section thirty-six, township forty, range seventy-nine west (Sec. 36, Tp. 40, R. 79 W.), granted by the State of Wyoming to William M. Fitzhugh, and by the latter assigned to the Midwest Oil Company, and in the certain lease granted by the Stock Oil Company to William M. Fitzhugh, and in certain agreements or leases from H. E. Stock, J. E. Stock, and others, with William M. Fitzhugh, and also in certain

drilling machinery and outfits, fixtures, and other appurtenances and personal property situate in, near or upon said property, and are desirous of selling all their right, title, interest, and estate of every kind and nature whatsoever in and to said property, leases, agreements, machinery, fixtures, appurtenances, and personal property, and the party of the second part as trustee for the Reed Investment Company, a corporation organized and existing under and by virtue of the laws of the State of Colorado, is desirous of securing in its behalf the exclusive right, option, and privilege to purchase from the parties of the first part all their said right, title, interest, and estate.

Now, Therefore, in consideration of the sum of thirty-five thousand dollars ($35,000.00) cash, in hand paid by the party of the second part to the parties of the first part, the receipt of which is hereby confessed and acknowledged, the parties of the first part have given and granted, and by these presents do give and grant, unto the party of the second part, his heirs, executors, administrators, or assigns, as trustee of said The Reed Investment Company, its successors and assigns, the exclusive right, privilege, and option to purchase of and from the parties of the first part, their heirs, executors, administrators, successors, or assigns, all said property, the description of which is hereinafter specified, at and for the total price and sum of three hundred and twenty-five thousand dollars ($325,000.00), upon the terms and conditions as hereinafter set forth, to-wit:

94 Thirty-five thousand dollars ($35,000.00) cash in hand to be paid upon the deposit of certain papers in escrow, hereinafter referred to coincident with the execution and delivery of this agreement, the receipt of which is hereby confessed and acknowledged, as the first payment and also as the consideration for the granting of this option as hereinabove specified.

One hundred thousand dollars ($100,000.00) on or before four (4) months from the date hereof.

Sixty-five thousand dollars ($65,000.00) on or before six (6) months from the date hereof.

One hundred and twenty-five thousand dollars ($125,000.00) on or before the first day of June 1912.

Provided, however, and it is agreed, that if and when the party of the second part makes any payment upon this option, he shall, at the date of making such payment, add and pay to the parties of the first part, in addition to the amount of such installment, an amount of money equivalent to six (6) per cent interest on the deferred portions of the price for which the property may be purchased hereunder.

And the parties of the first part, in consideration aforesaid, have agreed and hereby do agree to sell, convey, and transfer unto the party of the second part, his heirs, executors, administrators, successors, or assigns, in trust for The Reed Investment Company, its

successors or assigns, all their and each of their right, title, interest, and estate in and to all said property hereinabove and hereinafter referred to at any time, upon payment of the purchase price above stated.

The parties of the first part agree that coincident with the execution and delivery of this instrument proper conveyances of all their said right, title, interest, and estate and in and to all said property shall be signed and acknowledged by the parties of the first part, according to their respective interests therein, to the said The Reed Investment Company, which said conveyances then and there shall be placed in escrow with The Bank of California Nat. Ass'n. of San Francisco, to be delivered by said bank to the party of the second part, his heirs, executors, administrators, successors, and assigns, upon the completion of the payments hereinabove specified.

95 The said party of the second part, in case default be made in any payment or payments herein provided to be made, shall forfeit all sums theretofore paid to the parties of the first part, as and for liquidated damages, and all the rights of the said party of the second part hereunder shall immediately terminate, and his rights in, to, and concerning all of said property shall thereupon cease, and all conveyances so held by said escrow holder, upon such default shall be immediately delivered back to the parties of the first part; likewise, upon default, the party of the second part shall be in all respects released from all responsibility to make any further payments unto the parties of the first part, it being agreed that this instrument is an option granted to the party of the second part to purchase, upon the terms above stated, and not an obligation on his part so to do.

The party of the second part shall have the immediate possession of all of said property, and in the event any payment (provided to be made herein is not made as provided to be made) herein, then the parties of the first part shall have the right of immediately entering into the possession of said property and all thereof, and the party of the second part shall immediately surrender to the parties of the first part peaceable possession of said property and every part thereof.

The party of the second part also promises, agrees, and covenants to do and perform all the work or assessment work upon any and all of said locations now containing discoveries, required to be done by the laws of the State of Wyoming or the United States, or upon any lands by any private agreement or leases, and agrees to do the same as soon as possible and in every case to have the said assessment work fully performed and completed by the first day of November 1911, and in case said work, or any thereof, is not completed by said November 1st, said parties of the first part may re-enter into the possession of all of said property both real and personal and do such work as is not done at the charge and cost of the party of the second part, and may recover such cost from said party of the second part by action or otherwise.

In the event this option is finally exercised by the party of the second part, and full payments made, then the party of the second part, upon delivery of the leases and agreements hereunder to
96 be transferred, shall assume all the obligations thereof, required to be performed by grantee therein, so far as such obligations are binding upon the parties of the first part, or any of them.

The party of the second part shall have the right to use all of the machinery and property above referred to for the purpose of doing assessment and development work upon the said lands or any of them, but if default is made by said parties of the first part in any of the payments provided to be made herein, then any personal property used or consumed or injured or impaired by the said party of the second part shall be accounted for and replaced and restored to as good condition as when received by said party of the second part, ordinary wear and tear excepted; but this paragraph shall not apply to live stock, stock feed, groceries, and provisions now on hand at the camp of the parties of the first part in said field; as to the said live stock, party of the second part may, in thirty (30) days, purchase such thereof as he may desire, at a price to be agreed upon between Wm. G. Henshaw and the party of the second part; as to stock feed, groceries, and provisions now on hand, the party of the second part may use the same, but in the event of default hereunder shall either immediately replace the same amount of such articles, or pay the actual cost thereof; in the event of no default hereunder, the actual cost of such articles shall be paid for at cost by the party of the second part to the parties of the first part.

Time shall be of the essence of this agreement and of the making of all of the payments herein provided to be made, and runs to and binds the heirs, administrators, successors, representatives, and assigns of the parties hereto.

The mining locations and properties herein referred to and contemplated to be conveyed are situated in the so-called Salt Creek Oil Fields near Casper, in Natrona County, Wyoming, and also include all first parties' interest in a lease from the Stock Oil Company, and in a certain agreement between Wm. M. Fitzhugh and H. E. Stock, J. E. Stock, and others affecting certain lands in said county, and in a lease from the State of Wyoming to School Section Number thirty-six, Township forty, Range seventy-nine West (Sec. No. 36, Tp. 40, R. 79 W.), and for more specific description of the located lands and other rights conveyed reference is hereby made to
97 the deeds and transfers of even date herewith, placed in escrow in connection herewith.

All sums of money herein contemplated to be paid by the party of the second part shall be paid to The Bank of California Nat. Ass'n of San Francisco and shall by said bank be placed to the credit of Wm. G. Henshaw, who shall have the full, absolute and complete disposition and control of the same; upon such payments being duly made, the said bank shall give to the party of the second part an

acknowledgment and receipt therefor, which shall be a full acknowledgement and receipt by the parties of the first part of such payment to them and each of them by the party of the second part.

It is agreed, that the party of the second part, or his assigns, at any time during the term of this option, while the same is in force, may produce, take, and sell from the premises and property referred to and described in said conveyances and transfers so deposited in escrow, such an amount of oil as he or his assigns may desire, and that for seventy-five per cent (75%) of the total amount of oil so taken and produced from said premises the party of the second part or his assigns shall pay to the parties of the first part sixty (60) cents per barrel, which amount shall be paid to and received by the parties of the first part as a payment, upon the amount of the purchase price of the said property. Such amount shall be accounted for monthly by the party of the second part to the parties of the first part; in specifying said amount of 75%, such specification, it is agreed, shall not be construed as constituting any declaration binding upon any of the parties hereto as to the true extent of the first parties' interests in and to said property, affected by this agreement. The parties of the first part agree, that they are the sole persons interested in what is generally referred to and known as the Henshaw interest, as distinguished from the Fitzhugh's, in the property affected by this agreement, and that, if any person who is entitled to participate with the parties of the first part, or is in fact interested with them in the ownership of any part of said interest intended to be conveyed hereunder, through inadvertence or otherwise, has been omitted from the names of the grantors in the title papers deposited in escrow, parties of the first part will cause additional papers to be executed conveying such interests, it being expressly understood, that this clause
98 does not imply any obligation on the part of the parties of the first part with reference to the so-called Fitzhugh interest represented in the title by Wm. M. Fitzhugh and his wife.

It is further agreed, that, inasmuch as certain litigation is pending between Petroleum Maatschappig, of Salt Creek, and the parties of the first part, or some of them, and others, said litigation being commonly known as that between the Dutch and California interests, now pending in the District Court of Natrona County, Wyoming, and certain contests are pending also in the United States Land Office, affecting some of said properties, so far as the parties hereto can control the same, there shall be during the term of this option, no change whatever in the status of said litigation; the parties of the first page agree, that they will cause their counsel to cooperate with counsel for the party of the second part to maintain the present status and that, in the event any effort is made by the opponents of the parties of the first part to change the status of said litigation, or land office proceedings, the parties thereto will cooperate to maintain to the fullest extent the property rights and titles affected hereby unimpaired. All, however, at the proper cost and expense of the party of the second part.

It is expressly understood and agreed, that in the event of the failure of the party of the second part to exercise this option, and the property rights affected hereby revert to parties of the first part, then nothing in this agreement contained, or in the execution and delivery or contents of any other paper incidental to this agreement, or coincident herewith, contained, shall in any wise operate to the prejudice of any rights or claims which any of the parties hereto, whether of the first or second part, may, at any future time, see fit to assert as against the other, but in that event all the rights of the parties shall stand absolutely unimpaired, and with the same force and effect, as though this option had never been granted, or the transfers or conveyances, or other papers incidental hereto, had never been executed and the present status thereupon immediately restored; neither the granting of this option, nor its acceptance, nor any payments or payment made hereunder, shall prejudice the rights of either party as against the other, at any time, in the event of the failure of the party of the second part to make the payments aforesaid;
99 nor shall anything herein or in said other papers contained in such event be construed as a recognition, or definition of the extent of the rights of the parties of the first part, or of the party of the second part, or those identified in interest with him, or of the rights claimed by William M. Fitzhugh.

In Witness Whereof, the parties of the first part, some individually and some at this date acting through Wm. G. Henshaw, their agent and attorney in fact, and the party of the second part have hereunto set their hands and seals, the day and year first above written.

(Signed) Wm. G. Henshaw, [SEAL]
(Signed) Hatty T. Henshaw, [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(Signed) Tyler Henshaw, [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(Signed) Helen W. Henshaw, [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(Signed) Alla S. Chickering, [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(Signed) Henry D. Nichols, [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(Signed) Ethel K. Nichols, [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(Signed) E. M. Hall, [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(Signed) Lillie T. Hall, [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(Signed) F. W. Henshaw, [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(Signed) H. J. Knowles, [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*

(Signed) W. H. METCALF, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
(Signed) A. H. CHICKERING, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
(Signed) C. T. RODOLPH, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
(Signed) EMIL NUABAUMER, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
100 (Signed) P. C. BLACK, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
(Signed) HARRY CHICKERING, [SEAL]
By WM. G. HENSHAW, *his Atty. in Fact.*
---------- [SEAL]

Witnesses to each signature.

(Signed) O. H. SHOUP, [SEAL]
Trustee for and acting in behalf of
THE REED INVESTMENT COMPANY,
Party of the Second Part.

STATE OF CALIFORNIA,
County of Alameda, ss:

Before me, J. L. Meyer, a Notary Public in and for said county, in the state aforesaid, on this 25th day of July 1911, personally appeared Wm. G. Henshaw, appearing individually and also as attorney in fact for Hatty T. Henshaw, Tyler Henshaw, Helen W. Henshaw, Alla G. Chickering, Harry Chickering, Henry D. Nichols, Ethel K. Nichold, E. M. Hall, Lillie T. Hall, F. W. Henshaw, H. J. Knowles, W. H. Metcalf, A. H. Chickering, C. T. Rodolph, Emil Nusbaumer, and P. C. Black, said persons being personally known to me to be the persons whose names are subscribed to the foregoing instrument, and thereupon said individuals acknowledged that they, and each of them, made, executed, and delivered the said above and foregoing instrument of writing, as their free and voluntary act and deed, and as the free and voluntary act and deed of each of them, for the uses and purposes therein set forth; and said Wm. G. Henshaw thereupon acknowledged to me, that he signed, sealed, executed, and delivered the said instrument of writing in behalf of his principals as well as in his own behalf, as their free and voluntary act and deed, and as the free and voluntary act and deed of each of them, acting under a power of attorney from his said principals; all for the uses and purposes therein set forth.

In Witness Whereof, I have hereunto set my hand and notarial seal, this 25th day of July 1911. My commission expires March 5, 1913.

[NOTARIAL SEAL] (Signed) J. L. MEYER,
Notary Public within and for the
County of Alameda, State of California.

101 *Exhibit D*

This Agreement, made and entered into this 14th day of July, A. D. 1911, by and between William M. Fitzhugh of Alameda County, California, party of the first part, The Midwest Oil Company, an Arizona corporation, party of the second part, and The Reed Investment Company, party of the third part, Witnesseth:

That, Whereas, heretofore and on to-wit: the 3rd day of June, 1911, a certain contract was made and entered into between the said Fitzhugh, The Midwest Oil Company, and O. H. Shoup which contemplated the segregation of what was referred to as the Fitzhugh interest from that of his previous associates, William G. Henshaw and others, in certain so-called located lands, and a certain School section and a certain half section of the Stock Oil Company, held under lease by the said Fitzhugh, coincident with which agreement deeds were executed by said Fitzhugh, and wife to said O. H. Shoup, to be held by said Shoup subject to the purposes of said agreement and to the directions of The Midwest Oil Company, and upon segregation certain arrangements were provided for the payment for a certain proportion of the oil derived from said property to said Fitzhugh; and

Whereas the party of the third part now contemplates obtaining from said Henshaw and his associates an option for the purchase of all their right, title, and interest in and to the located lands, the School Section and said Stock Oil Company half section above referred to, and before obtaining said option desires to obtain from the parties of the first and second part an agreement as to what the segregation of lands shall be in the event it acquires finally the interests of said Henshaw and associates and to agree upon the division of oil to be produced for the purpose of procuring the full performance of said contract of June 3rd, 1911.

Now, Therefore, to the end that there may be an understanding and agreement between the parties prior to obtaining from the said Henshaw and his associates an option to purchase all their right, title, and interest in said property and other valuable considerations moving from each party to the other, the receipt of which is hereby con-

102 fessed and acknowledged, the parties hereto have agreed and hereby do agree with each other as follows, to-wit:

1. In the event an option is obtained from the said Henshaw and his associates for the purchase of all their right, title, and interest in said properties hereinabove referred to and the purchase price under said option is finally paid by the optionee or its assigns, then upon securing the conveyance of said interest of the said Henshaw and his associates in the said lands as between the interest which is to become subject specifically to the operation of the contract of June 3rd, 1911, on the one side and the purchase of the interests of said Henshaw and associates on the other, it is hereby agreed to be upon the basis that the Northwest Quarter of each location of one hundred sixty acres of located land shall be retained by O. H. Shoup under said contract subject to the directions of the Midwest Oil Company, and be

specifically subjected and held for the purpose of enabling the performance of the said contract of June 3rd, 1911, between the parties thereto, and as to the School Section 36, Township 40, Range 79 West, thirty-seven and one-half percent thereof shall be set apart and held specifically subject to said last mentioned contract for the purposes thereof, said thirty-seven and one-half per cent thereof to be the following portions, to-wit:

The Northwest Quarter, the Northwest Quarter of the Northeast Quarter, and the Northwest Quarter of the Southwest Quarter of said Section, being two hundred forty acres of said Section; and as to said East Half of Section twenty-five, being the Stock Oil Company land referred to in said contract of June 3rd, 1911, there shall be set apart and specifically held, subject to said contract, and to enable the fulfillment thereof and segregated, thirty-seven and one-half per cent of said East Half of Section twenty-five, being, to-wit: one hundred twenty acres thereof, described as follows, to-wit:

The west Half of the Northeast Quarter and the Northwest Quarter of the Southeast Quarter of said Section.

It being the intention of the parties that there shall be always held and subjected to the operation of the contract of June 3rd, 1911, thirty-seven and one-half per cent of the said School Section and the
103 said Stock Oil Company land, and twenty-five per cent of the acreage embraced in the so-called located land.

2. If in securing said option from said Henshaw and associates arrangements are made for the production from said lands, or any part thereof, and oil is actually produced from said lands, or any part thereof, prior to final payment and before segregation on the basis hereinabove provided for, then seventy-five per cent of the oil produced and handled through the pipe line shall be, during said time, considered the property of The Reed Investment Company for use by it in connection with the said option requirements, and twenty-five per cent thereof shall be considered the property of The Midwest Oil Company to be subjected to the terms of said contract of June 3rd, 1911, except as to the School Section and the Half Section of the Stock Oil Company, the proportion of oil to be considered as subject to the contract of June 3rd, 1911, shall be thirty-seven and one-half per cent of the amount produced therefrom handled through pipe line irrespective of the amount allotted to The Reed Investment Company for use under the terms of said option; and after segregation has been made The Reed Investment Company, or its assigns, then owners of the land segregated, shall, out of the oil produced from the lands so segregated to it, deliver to The Midwest Oil Company for the use of said Fitzhugh, a sufficient quantity of oil to make up for the use of said Fitzhugh that part of the oil handled through the pipeline during the period of said option, which is required to bring him two-thirds of fifty per cent of the oil handled through said pipe line during said time, said oil so delivered to The Midwest Oil Company for the use of said Fitzhugh to be paid for by The Midwest

Oil Company to the said Fitzhugh at the price set forth under the terms of said contract of June 3rd, 1911; provided that whenever said option is forfeited, if for any reason it should be, this agreement is at an end and the said contract of June 3rd, 1911, remains in full force and effect without in any respect being modified by this contract, except as to oil obtained prior to the time said option is forfeited, and provided further that no extension of time within which completion of payments is to be made to Henshaw and associates by The Reed Investment Company, or its assigns, beyond June 1st, 1912, shall be sought for or agreed to without the consent of said
104 Fitzhugh first thereunto had and obtained. The provisions of this paragraph terminate upon the final exercise of the option.

3. The Midwest Oil Company and The Reed Investment Company for themselves, their successors or assigns, agree that if said interests of said Henshaw and associates are acquired and the segregation if made upon the basis hereinabove set forth, that they will enter into no contract or arrangement that does not fully protect and enable the Midwest Oil Company to perform the obligations of said contract of June 3rd, 1911, with said Fitzhugh.

4. If no arrangement is made with said Henshaw for the purchase and acquisition of his interests on or before August 1, 1911, this contract shall be null and void.

In Witness Whereof the corporate parties hereto have caused these presents to be signed by their respective corporate officers they being first thereunto duly authorized, and the corporate seals affixed and the individual party has hereunto set his hand and seal the day and year first above written.

WILLIAM M. FITZHUGH, [SEAL]
Party of the First Part.

THE MIDWEST OIL COMPANY,
[SEAL] By O. H. SHOUP, *President.*
Attest:

J. L. WARREN, *Secretary.* [SEAL]

THE REED INVESTMENT COMPANY,
[SEAL] By A. M. JOHNSON, *Vice President.*
Attest:

O. H. SHOUP, *Secretary.*

DENVER, COLO., *July 14, 1911.*

THE MIDWEST OIL COMPANY, *City.*

GENTLEMEN: In consideration of your entering into the contract of even date herewith and with The Reed Investment Company, and to the end that my present status may be maintained until an option from Henshaw if obtained, is either exercised or forfeited, I hereby agree that until such option, if obtained, is either exercised or forfeited, my contract of June 3rd, 1911, with you and with O. H.
105 Shoup, and the contract of even date herewith with you and The Reed Investment Company shall be considered personal to me and nonassignable.

WILLIAM M. FITZHUGH. [SEAL]

Exhibit H

Thereupon the following communication was presented to the Board of Directors:

COLORADO SPRINGS, COLO., *May 10, 1912.*

To the Board of Directors of The California Oil Company:

GENTLEMEN: The undersigned is in such position that he is able to cause a quitclaim deed of the title formerly held by W. G. Henshaw and his associates, in and to the property hereinafter described, to-wit: All of Section 26, California, Los Angeles, Montana, and Idaho Placer claims, 640 acres, all in Township 40, Range 79 West; and all the right, title, and interest of The Reed Investment Company in 62½% of School Section 36, Township 40, Range 79 West and 62½% of the East Half of Section 25, both of said interests being leases upon said respective areas, and being that 62½% of each of said tracts remaining after the segregation to The Midwest Oil Company of 37½% of said School Section and said ½ Section of Stock Oil Company had been made and each had become effective under a contract of July 14, 1911, between The Midwest Oil Company, W. M. Fitzhugh, and O. H. Shoup, as Trustee, for The Reed Investment Company; to be transferred, as such title is supplemented by virtue of an agreement of segregation existing between The Midwest Oil Company and The Reed Investment Company, and is willing to cause said title to be conveyed from the present holders thereof coupled with the rights under said agreement of segregation so far as they affect said land, to your company in consideration of the issuance to the undersigned, full paid and nonassessable, of 499,995 shares of your capital stock, as a means of representing and representing the arrangement hereafter specified and in consideration of the understanding that such arrangement will be carried into effect, to-wit:

The transfer of this property although by deed absolute to your company, is upon the condition to be accepted and agreed to by
106 the stockholders of your company and subject to which stock shall hereafter be issued and transferred, as follows:

Your company is organized and intended as a close corporation representing the following proportionate interests in the stock and property, to-wit:

V. Z. Reed	64.125
O. H. Shoup	17.1
B. H. Hopkins	10.
K. C. Schuyler	5.355
J. L. Warren	.855
A. M. Johnson	.855
C. A. Fisher	.855
N. S. Wilson	.855

and the organization of the corporation was for convenience in operation and to hold the legal title intact in one entity for convenience of defending the rights of said lands; but the fact is that each stockholder according to his holdings of stock is to be and if this proposal is accepted it must be considered as agreed that he shall be, the owner

of that proportion of oil in said premises above described that his stock holdings bears to the total capital stock of the company, to-wit: the percentage of the oil contents above specified and set opposite the name of each with the right to receive said percentages, and when and as the same is produced from said ground it shall be considered to be the property of the said individuals above named in the proportion of and to the extent of the percentages above specified, and when said oil is sold it may be sold either jointly in the name of your company, and the purchase price be delivered by the purchaser directly to each of said above-named persons, or to your company as trustee, and said proceeds immediately distributed among said parties. Subject to a reservation of 10% of the amount of such proceeds for the cost of operating said property; any amount of said fund reserved remaining on hand at the end of each year shall be distributed in the above proportions; if the entire fund shall be distributed and expense be incurred each of said persons above named receiving said stock shall pay his proportionate part of said expense according to the percentages above set forth. These provisions shall be binding
107 upon any transferee of the stock of this company or any part thereof, from the above-named holdings or such transferee.
Respectfully,

(Signed) O. H. SHOUP.

Exhibit I

The board of Directors thereupon carefully considered said proposition and being of the opinion that said titles were presently and prospectively reasonably worth the sum of $499,995 upon motion duly made and seconded it was unanimously resolved that said proposition be accepted and thereupon the President and Treasurer were authorized to make, execute, and deliver said stock unto the said O. H. Shoup, Trustee, or to such persons as he might designate when conveyance in the form satisfactory to counsel for the Company should be received.

Exhibit J

DECLARATION OF TRUST

We, The Pinero Oil Company, hereby declare that we hold all the legal right, title and interest which we have in and to all the oil contained in the following described lands, situate in the County of Natrona, State of Wyoming, to-wit:

The East Half of the Northeast Quarter (E½ NE¼), the Southwest Quarter of the Northeast Quarter (SW¼NE¼), the Northeast Quarter of the Southeast Quarter (NE¼ SE¼), and the East Half of the West Half (E½, W½), of section twenty-four (24), Township 40 North, Range 79 West; known as the Otto, Engine, Pinero, and Naphtha Placer Claims;

The East Half of the East Half (E½, E½), the Southwest Quarter of the Northeast Quarter (SW¼, NE¼), and the Southwest Quarter of the Southeast Quarter (SW¼, SE¼), of Section Thirteen (13), Township 40 North, Range 79 West; known as Detroit and Motor Placer Claims.

And in and to each and every contract or lease heretofore, or which may hereafter be, entered into by us, affecting the production, sale or other disposition of said oil.

108 In Trust, nevertheless, for the following-named persons, in the proportions set opposite their respective names, to-wit:

Verner Z. Reed	44.125
Mary Dean Reed	5.000
Verner Z. Reed, Trustee for Verner Z. Reed, Jr.	5.000
Verner Z. Reed, Trustee for Margery Verner Reed	5.000
Verner Z. Reed, Trustee for Joseph Verner Reed	5.000
O. H. Shoup	17.100
H. H. Hopkins	10.000
K. C. Schuyler	5.355
J. L. Warren	.855
A. M. Johnson	.855
C. A. Fisher	.855
N. S. Wilson	.855

who shall have full right and power to produce, take and remove said oil from said premises upon the expiration or other termination of any and all contracts or leases wherein we have heretofore granted said right and power to other parties, with full right of ingress and egress to and from said premises for said purposes.

In Witness Whereof, we have hereunto, and unto eleven copies hereof, caused our corporate name to be signed and our corporate seal to be affixed by our proper officers, thereunto duly authorized, at Denver, Colorado, this 26th day of May, A. D. 1915.

THE PINEBO OIL COMPANY,
(Sd.) By TYSON DINES, JR.,
Its Vice-President.

Attest:

(Sd.) C. E. TITUS, *Secretary.* [SEAL]

109 *Exhibit L-1*

Minutes of a Special Meeting of the Board of Directors of The Wyoming Associated Oil Corporation

A Special Meeting of the Board of Directors of The Wyoming Associated Oil Corporation was held on the 18th day of July 1919 at 2 o'clock P. M. at 1010 First National Bank building, in the City and County of Denver, State of Colorado, pursuant to a waiver of notice signed by all of the Directors.

The following directors were present: N. S. Wilson, J. L. Warren, F. C. Roberts, Verner Z. Reed, Jr., D. M. Harrington, being the entire Board of Directors.

Mr. N. S. Wilson, the President, acted as Chairman of the meeting, and Mr. J. L. Warren, the Secretary, acted as the secretary thereof.

The Secretary presented the Waiver of Notice of the Meeting, signed by all of the Directors.

A written proposal was thereupon presented to the meeting and read to the Directors.

Said proposal is the following:

PROPOSAL

DENVER, COLORADO, *July 18, 1919.*

To the Board of Directors of The Wyoming Associated Oil Corporation:

GENTLEMEN: On the 17th day of June 1919, a certain Contract was entered into, to which the undersigned Mary Dean Reed is one of the parties of the third part, and the undersigned, Salt Creek Producers Association, Incorporated, is the party of the fourth part. A true and complete copy of said contract is attached to this proposal and marked "Exhibit 1."

Your corporation, The Wyoming Associated Oil Corporation, has now been organized under the laws of Delaware, to carry on the functions of the corporation referred to in said Contract (Exhibit 1) as the "New Corporation."

In view of the foregoing matters, I, Mary Dean Reed, hereby
110 propose to convey and transfer, of course to be conveyed and transferred unto The Wyoming Associated Oil Corporation, by proper instruments, all those items of property which the parties of the third part, called the "Vendors" in said contract, undertake to convey, assign, or transfer unto the corporation referred to therein as the "New Corporation."

And the Salt Creek Producers Association, Incorporated, hereby proposes to convey and transfer, or cause to be conveyed and transferred, unto The Wyoming Associated Oil Corporation by proper instruments all those items of property which the party of the fourth part, called the "Vendee" in said Contract, undertakes to convey, assign, or transfer unto the corporation referred to therein as the "New Corporation."

And, further, the undersigned jointly propose to cause the ten corporations, which are parties of the second part to said contract, and are referred to therein as the "Producing Companies," to convey and transfer by proper instruments unto The Wyoming Associated Oil Corporation, all those items of property which said Producing Companies in said contract undertake to convey, assign, or transfer unto the corporation referred to therein as the "New Corporation."

The undersigned have heretofore determined that the five shares to be issued to the directors of your corporation, under the terms of said Exhibit 1 shall be issued, one share each to N. S. Wilson, J. L. Warren, F. C. Roberts, Verner Z. Reed, Jr., and D. M. Harrington.

The undersigned, Salt Creek Producers Association, Incorporated, further represents to you that it is the holder, by five separate assignments from N. S. Wilson, J. L. Warren, F. C. Roberts, Verner Z. Reed, Jr., and D. M. Harrington, respectively, of the subscription rights for nineteen shares from each of said five persons.

The undersigned, Mary Dean Reed, further represents to your corporation that the several interests of the persons and corporations designated as "Vendors" in Exhibit 1 are as set forth in the tabulation which appears below.

In consideration of the transfer of the foregoing proper y to
111 your corporation, you shall issue its entire capital stock, consisting of Three Hundred and Fifty Thousand (350,000) shares without nominal or par value, fully paid and nonassessable, unto the following persons and corporations in the amounts set opposite their several names, to-wit:

Names		*Number of shares*
N. S. Wilson	1	
J. L. Warren	1	
F. C. Roberts	1	
Verner Z. Reed, Jr	1	
D. M. Harrington	1	
		5
Salt Creek Producers Association, Incorporated		50,000
Salt Creek Producers Association, Incorporated		107,625
Salt Creek Producers Association, Incorporated		23,472
Mary Dean Reed, Executrix of the Estate of Verner Z. Reed, deceased	30,555	
Mary Dean Reed	5,848	
Margery Verner Reed	5,848	
Verner Z. Reed, Jr	5,848	
Joseph Verner Reed	5,848	
The Equitable Trust Company of New York, Trustee	10,527	
The Equitable Trust Company of New York, Trustee	10,526	75,000
Tyson Dines, Jr., Trustee		93,898
Total Shares		350,000

Yours truly,

MARY DEAN REED.

SALT CREEK PRODUCERS ASSOCIATION, INCORPORATED,

[SEAL] By N. W. WILSON, *President.*

Attest:

J. L. WARREN, *Secretary.*

112 *Exhibit 1 to proposal*

Memorandum of Agreement made in triplicate at Denver, Colorado, this 17th day of June, 1919, by and between The Midwest Refining Company, a Maine corporation, hereinafter called the "Refining Company," as party of the first part, The Barbadoes Oil Company, The Pinero Oil Company, The Bluestone Oil Company, The Henshaw Oil Company, The Control Oil Company, The Crescent Oil Company, The Fitzhugh Oil Company, The Seattle Oil Company, The California Oil Company, all Arizona corporations, and The

Castle Creek Oil Company, a Wyoming corporation, hereinafter called the "Producing Companies," as parties of the second part, Mary Dean Reed, Individually, and as devisee and legatee under the will of Verner Z. Reed, deceased, Mary Dean Reed, as executrix of the estate of said Verner Z. Reed, deceased, Mary Dean Reed, as guardian of the estates of Verner Z. Reed, Jr., and of Joseph Verner Reed, both minors, Mary Dean Reed, as trustee for the said Verner Z. Reed, Jr., and for the said Joseph Verner Reed, and for Margery Verner Reed, Margery Verner Reed, The Equitable Trust Company of New York, a New York corporation, as Trustee for Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed, under Trust Agreement of October 4, 1900, said The Equitable Trust Company of New York, as Trustee for Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed under Trust Agreement of August 23, 1902, hereinafter called the "Vendors," as parties of the third part, and Salt Creek Producers Association, Incorporated, a corporation of the State of Virginia, hereinafter called the "Vendee," as party of the fourth part, Witnesseth: Whereas, the Producing Companies own certain assets, consisting chiefly of interests in oil lands in the State of Wyoming, and are desirous of selling, assigning transferring, and conveying all of their respective assets (subject to the reservation hereinafter specified) in the manner, for the consideration and subject to the terms and conditions hereinafter specified; and

Whereas, the Refining Company on to-wit the 21st day of February 1914, made a contract with the Producing Companies concerning, among other things, the oil and gas thereafter to be produced from the said oil lands in which said Producing Companies
113 were interested, said contract running for a period of twenty years from the 1st day of January 1914, and now not being satisfactory to any of the parties thereto; and

Whereas, controversies have arisen as to the interpretation of said contract of February 21, 1914, and as to the rights and duties of the respective parties thereunder and all parties thereto desire finally to settle and adjust all such controversies; and

Whereas, the Vendors and the Vendee are now and for a long time prior hereto have been the owners of the oil content of all the oil lands of each and all of said Producing Companies, except said The Castle Creek Oil Company under and by virtue of agreements and instruments, the terms of which are known to and understood by all of the parties hereto; and

Whereas, the parties hereto are now desirous of rearranging and adjusting their interrelations and respective interests in accordance with the terms and conditions hereinafter set forth.

Now, Therefore, in consideration of the premises and of the covenants and agreements to be faithfully kept and performed by the respective parties hereto, as hereinafter set forth, it is mutually covenanted and agreed by and among the parties hereto as follows, to-wit:

ARTICLE I

SECTION 1. That on or before the 15th day of July, 1919, a corporation (hereinafter referred to as the "New Corporation") shall be organized under the direction and supervision of the Producing Companies subject to the approval as to the name thereof and as to the articles of incorporation and by-laws and as to all matters of detail by the attorneys for the Vendee, and to be incorporated under the laws of the State of Delaware, with all appropriate powers and especially authorized to carry on business in the State of Wyoming. Such corporation shall have a board of five directors. Two of the first board shall be named by Mary Dean Reed, and the remaining three shall be named by the Vendee. Cumulative voting shall be provided in the charter or articles of incorporation. Such corporation shall have an authorized capital of three hundred fifty
114 thousand (350,000) shares of no par value. All expenses of incorporating and organizing said company shall be borne by said company. Of said Company, Dines, Dines & Holme of Denver, Colorado, shall be the General Counsel, and shall attend to and have supervision over all of its legal affairs.

SECTION 2. That the Producing Companies shall on or before the 20th day of July, 1919, severally convey, assign and transfer unto the New Corporation by instruments approved by the general counsel of said New Corporation, all of their respective assets of every kind and wherever situate, whether in the State of Wyoming or elsewhere; except settlements in respect of impoundments, gas and current oil to June 1, 1919; and from time to time thereafter, upon demand of the Vendee, or of the said New Corporation, will make, execute and deliver to it such deeds or instruments of further assurance in respect to said assets or any thereof as counsel for the New Corporation, will make, execute and deliver to it such deeds or instruments of further assurance in respect to said assets or any thereof as counsel for the New Corporation may advise; and on the demand of the New Corporation the Vendors agree to cause the said Producing Companies to be wound up and dissolved.

SECTION 3. That the Vendors and the Vendee shall on or before the 20th day of July, 1919, severally convey, assign and transfer as of June 1, 1919, by instruments approved by the general counsel of the said New Corporation, all of their respective interests in said oil content of all the oil lands of each and all of said Producing Companies, except said The Castle Creek Oil Company; and from time to time thereafter, upon demand of the said New Corporation, will make, execute and deliver to it such deeds or instruments of further assurance in respect to said interests or any thereof as its counsel may advise.

SECTION 4. That said Vendee shall also on or before the 20th day of July, 1919, adjust and settle, or cause to be adjusted and settled, all conflicts, controversies, disputes, and adverse claims existing or

claimed to exist between the Producing Companies or any of them on the one part and said Vendee, and any of its allied corporations or organizations on the other part, and shall on or before July 20, 1919, convey, transfer or assign to said New Corporation all titles or interests it has or controls in or to any or all of the lands
115 in which said Producing Companies claim title or interest, and said Vendee shall thereafter from time to time, as required, convey, transfer or assign to said New Corporation any and all interests, rights or titles which it may hereafter acquire or control in said land.

In consideration whereof, the Vendee covenants and agrees with the Producing Companies and with the Vendors as follows, to-wit:

ARTICLE II

SECTION 1. That on or before the 20th day of July 1919, the Vendee, in addition to the further payments hereinafter specified to be made by the Vendee, shall pay or cause to be paid the sum of Four Million Dollars ($4,000,000) in New York Exchange to The Equitable Trust Company of New York, subject to the order of Mary Dean Reed.

SECTION 2. That immediately after the acquisition by the said New Corporation of the assets to be transferred to it by the Producing Companies, by the vendors and by the Vendee, as provided in Sections 2 and 3 of Article I hereof, and in consideration of such transfer, said New Corporation shall issue certificates for its entire authorized capital of three hundred fifty thousand (350,000) shares, full paid and non-assessable, to the following named persons in the amounts set opposite their respective names, to-wit:

Name	*Number of shares*
To the persons named as Directors, as hereinbefore provided, as qualifying shares	5
To Vendee, as consideration for the adjustments and settlements provided for in Section 4, Article I, hereof (Lot A)	50,000
To Vendee, or its assignee (Lot B)	107,625
To Vendee, or its assignee (Lot C)	23,472
To the Vendors, seventy-five thousand (75,000) shares to be distributed as their respective interests may appear	75,000
Tyson Dines, Jr., as Trustee for the persons named in, and subject to the provisions of Section 3 of this Article II, hereof	93,898
Total	350,000

116 SECTION 3. That the said Tyson Dines, Jr., as trustee shall hold said ninety-three thousand eight hundred ninety-eight (93,898) shares of the stock of the New Corporation upon the following trusts, to-wit:

a. From time to time as dividends on said stock may be declared, and paid, and other moneys come into said trustee's hands, to pay over all said funds to the Vendee or its order, unto such time as the aggregate of said funds plus the dividends paid on the twenty-three thousand four hundred seventy-two (23,472) shares of the stock of said New Corporation, issued in the Vendee as "Lot C" above de-

scribed, shall equal the principal sum of Four Million Dollars ($4,000,000), plus interest on said principal sum of Four Million Dollars ($4,000,000), at the rate of six per cent (6%) per annum from the 20th day of July 1919, until paid. Interest shall be payable yearly and all payments made by said Trustee to the Vendee and all dividends received by the Vendee on the stock described as said (Lot C) shall be deemed payments on account of interest theretofore payable, and after payment of interest shall be deemed to be payments on account of said principal sum of Four Million Dollars ($4,000,000), but no interest shall be charged or paid upon interest.

b. As soon as the payments provided for in Paragraph a last above set out are completed in accordance with the provisions of said paragraph a, and in any event not later than twenty-one years after the death of said Tyson Dines, Jr., said trustee shall wind up the trust immediately by assigning and transferring all of said stock so held in trust by him to said Vendors, as their respective interests may appear. In the same proportion, he shall pay over to said Vendors any moneys remaining in his hands.

c. As long as said stock remains subject to said trusts, it shall be voted by said trustee.

d. In the event of the resignation, death of inability of said Tyson Dines, Jr., to act as said trustee, he shall be succeeded by a successor in trust to be named by Mary Dean Reed, who shall be subject to all the duties and exercise all the rights hereinabove conferred upon said Tyson Dines, Jr.

SECTION 4. That as further consideration for the agreement of the Vendors herein set forth, the Vendee shall make further pay-
117 ments to the Vendors and to Tyson Dines, Jr., Trustee, as their respective interests may appear; said payments to be made on or before the 20th day of each month, beginning with July 1919, and continuing through the month of December 1933; the final payment to be made on or before the 20th day of January 1934. The aggregate sum to be paid on any given payday shall be determined as follows:

Five days before each said payday the Refining Company and the New Corporation shall render a joint written statement to the Vendee of the total number of barrels of crude oil which under Exhibit A hereto attached, is to be finally settled and paid for in full on the 20th day of the current month, including in such number all barrels released from Government impoundment and not settled for previously.

The said total number shall be multiplied by four and eight hundred twenty-six thousandths cents ($0.04826), and the aggregate payment distributable on that payday shall be the product of such multiplication, provided the given payday occurs prior to the winding up of the trust as specified in paragraph b of Section 2 of this Article II; if it occurs after such winding up, the total product of such multiplication shall go to the Vendors as their interests may then appear.

If and whenever prior to January 1, 1934, the Refining Company

shall increase the base price as defined in Exhibit A, attached hereto, upon which its settlements for crude oil are made with the New Corporation, to one dollar forty-two and a half cents ($1.425) or more per barrel, then the foregoing payments shall cease for such period as said base price may remain at or above one dollar forty-two and a half cents ($1.425) per barrel, but said payments shall be resumed whenever said base price for crude oil may be placed below one dollar forty-two and a half cents ($1.425) per barrel.

ARTICLE III

It is mutually agreed:

SECTION 1. That on or before the 20th day of July 1919 a contract in the form set out in Exhibit A, hereto attached, shall be executed by the parties thereto, to-wit: the New Corporation and the Refining Company.

SECTION 2. That all matters and disputes between the Refining
118 Company and each and all of the other parties hereto have been and now are hereby finally settled and adjusted and that said contract of February 21, 1914, shall be rescinded as of June 1, 1919, on the date of the execution of Exhibit A, by the parties thereto, provided that all rights of the Vendors in or to any moneys impounded by the Refining Company at the instance of the United States Government shall, as soon as possible, be adjusted and any moneys thereupon due to the Vendors, or any thereof, shall be paid to the said Vendors as their respective interests may appear.

SECTION 3. That the true intent and meaning of this contract is that for the considerations herein mentioned all property and interests in the Salt Creek Oil Fields, owned by the late Verner Z. Reed at the time of his death, and coming within the general arrangement made by him in his life time, by which he accepted sixty-four and one hundred twenty-five thousandths per cent (64.125%) of such property and interests, should be vested in the New Corporation and all such further assurances as may be necessary to carry out such intent shall be executed. These interests include those in The Colorado Oil Purchasing Company, The Economy Oil Company of Montana, The Success Oil Company of Montana, The Jantha Mining Company, and The New Bradford Oil Company.

SECTION 4. That the Refining Company shall at all times pay the New Corporation at least as much as the Refining Company pays The Midwest Oil Company for crude oil, and shall make with said New Corporation as favorable a contract covering gas production and use as it from time to time has with The Midwest Oil Company.

SECTION 5. That whenever the Refining Company or the Vendee holds in any property an undivided or joint interest with the Producing Companies or the Vendors, such undivided or joint interest shall be promptly turned over to the New Corporation.

SECTION 6. That benefits and burdens of this agreement inure to and shall be binding upon the heirs, executors, administrators, successors, and assigns of the respective parties hereto.

In Witness Whereof, the corporate parties hereto have caused their corporate names to be signed and their corporate seals to be
119 affixed by their respective officers thereunto duly authorized and the other parties have hereunto affixed their hands and seals at Denver, Colorado, the day and year fiorst aboye written.

[CORPORATE SEAL] THE MIDWEST REFINING COMPANY,
By (Sgd.) T. A. DINES, *Its Vice-President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE BARBADOES OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE PINERO OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE BLUESTONE OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE HENSHAW OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE CONTROL OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE CRESCENT OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

120 [CORPORATE SEAL] THE FITZHUGH OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE SEATTLE OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE CALIFORNIA OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*
Attest:
C. E. TITUS, *Secretary.*

[CORPORATE SEAL] THE CASTLE CREEK OIL COMPANY,
By (Sgd.) MARY DEAN REED, *Its President.*

Attest:
C. E. TITUS, *Secretary.*

MARY DEAN REED,
Individually and as devisee and legatee under the will of Verner Z. Reed, deceased.
MARY DEAN REED,
As Executrix of the Estate of said Verner Z. Reed, deceased.
MARY DEAN REED,
As Guardian of the Estate of Verner Z. Reed, Jr., and of Joseph Verner Reed, both minors.
MARY DEAN REED,
As Trustee for the said Verner Z. Reed, Jr., and for the said Joseph Verner Reed, and for Margery Verner Reed.
MARGERY VERNER REED.
THE EQUITABLE TRUST COMPANY
OF NEW YORK,
As Trustee for Mary Dean Reed et al., under Trust Agreement of October 4, 1900.
By J. N. BABCOCK, *Its Vice-President.*

Attest:
N. G. COBBINS, *Asst. Secretary.*

121 THE EQUITABLE TRUST COMPANY
OF NEW YORK,
As Trustee for Margery Verner Reed, et al., under Trust Agreement of August 23, 1902.
By J. N. BABCOCK, *Its Vice President.*
Attest: N. G. COBBINS, *Secretary.*
SALT CREEK PRODUCERS ASSOCIATION,
INCORPORATED,
By (Sgd.) N. S. WILSON, *Its Vice-President.*
Attest: J. L. WARREN, *Secretary.*
[CORPORATE SEAL]

Exhibit A to agreement

This Contract, made and entered into this ____ day of ____, 1919, by and between the_____, a corporation of the State of_____, hereafter called the Producing Company, Party of the First Part, and The Midwest Refining Company, a corporation of the State of Maine, hereafter called the Refining Company, Party of the Second Part, Witnesseth:

That Whereas, the Producing Company is in possession of and owns certain interests in oil lands situated in the Salt Creek Oil Fields, Natrona County, State of Wyoming, and is desirous of entering into an arrangement with the Refining Company for the

sale to and purchase by the Refining Company of crude oil hereafter to be produced from said lands; and

Whereas, the Refining Company is the owner of certain refining plants at Casper, Wyoming, and is engaged in the business of purchasing, transporting, refining, and marketing crude oil and the products thereof; and

Whereas, the parties hereto mutually desire to effect an agreement establishing for a term of years their relations respecting the production, purchase, and sale of crude oil upon the terms and conditions hereinafter set forth:

Now, Therefore, in consideration of the payment of One ($1.00) Dollar and other good and valuable considerations, receipt of which is hereby acknowledged, and mutual benefits derived and to be derived from the faithful performance of the terms and con-
122 ditions hereinafter set forth, the parties hereto mutually covenant and agree as follows, to-wit:

First: That all said oil lands now in the possession of the Producing Company, or hereafter in the possession of the Producing Company, in said Salt Creek Oil Fields (Natrona County, Wyoming), shall be and hereby are subjected to the terms and conditions of this agreement.

Second: The Refining Company shall, as from the first day of June 1919 to the first day of January 1934 produce from said lands of the Producing Company and purchase from that Company at least one-third (⅓) of the total amount of oil at any time then being produced or purchased by the Refining Company in or from said Salt Creek Oil Fields (Natrona County, Wyoming), subject, however, to a deduction from said one-third (⅓) of the same amount of oil as may be concurrently deducted from the aggregate deliveries of oil by The Midwest Oil Company to the Refining Company, but in no event shall such deduction exceed one-twelfth ($\frac{1}{12}$) of the total amount of oil at any time then being produced or purchased by the Refining Company in or from said Salt Creek Oil Fields (Natrona County, Wyoming); provided, that at no time shall there be any such deduction except for the purpose of enabling the Refining Company to buy Independent crude oil.

The obligation of the Refining Company to take such fraction (one-third) of said oil from the lands of the Producing Company shall continue only so long as the lands of the Producing Company are capable of producing that amount of oil, but whenever the Refining Company, either under its now existing contractual obligation, or under future modifications or changes thereof, may legally produce from said oil lands of the Producing Company and purchase from it such quantity of oil in excess of said one-third (⅓) as will make the ratio between the oil purchased from the Producing Company and the total amount of oil produced or purchased by the Refining Company in or from said Salt Creek field more nearly equal the ratio between the estimated oil content of the lands of said Produc-

ing Company and the total estimated oil content of said field, the Refining Company hereby agrees to increase the amount so produced and purchased from time to time up to the full amount of said proportion, and in excess thereof if it so desires.

123 Third: The Refining Company shall be given and granted, and hereby is given and granted, for the period extending from the first day of June 1919, to and until the first day of January 1934, subject to the forfeiture clause hereinafter set forth, exclusive possession, right of occupation and enjoyment of said oil lands of the Producing Company for the purpose of producing oil therefrom and of purchasing all oil so produced; the Refining Company shall pay all the costs of sinking wells on said lands required to produce said oil, and all expenses of the production, the storage, and the transportation thereof, except that the Refining Company shall have the use of all storage facilities, pipe lines, tools, and machinery now in said fields and used in connection with the development, production, and storage of oil, and of all buildings in connection therewith, and shall have free of charge the oil and gas used in connection with drilling and domestic service on the lands of the Producing Company.

As to the gas produced over and above that used in drilling and domestic service as aforesaid, the Producing Company reserves the right of entry for the purpose of conserving and utilizing the gas and values thereof.

A deduction of three per centum (3%) for moisture and basic sludge shall be allowed upon crude oil.

Fourth: All taxes on all oil produced shall be borne one-half (½) by the Producing Company and one-half (½) by the Refining Company; all taxes on physical property shall be borne by the Refining Company.

Five: A—During the period from June 1st, 1919, to June 1st, 1922, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

When the average price received for gasoline at said Casper (Wyoming) refinery during any month is eighteen cents (18c) per gallon, and the average price received for Water White Kerosine Oil during said month is seven and one-half cents (7½c) per gallon, the crude oil taken under this contract for said month shall be settled for at the base price of one dollar thirty-two and one-half cents (1.32½) per barrel. If the average price received by the Refining Company during any month for gasoline at its Casper (Wyoming)

124 Plant, shall be less or more than eighteen cents (18c) per gallon, then for each cent increase or decrease over or under said sum of eighteen cents (18c) there shall be added to or subtracted from said base price of one dollar thirty-two and one-half cents ($1.32½) five cents (5c) per barrel in order to compute the settlement price of crude oil for said month, and if the said average price received by the Refining Company at its said Casper Plant for Water White Kerosine Oil shall be less or more than seven and one-half

cents (7½c) per gallon, then for each cent increase or decrease over or under said sum of seven and one-half cents (7½c) there shall be added to or subtracted from said base price of one dollar thirty-two and one-half cents ($1.32½) two and one-half cents (2½c) per barrel in order to compute the settlement price of crude oil for said month. Decreases or increases of less than one cent (1c) in the price of either gasoline or Water White Kerosine Oil shall be figured proportionately.

B—During the period from June 1st, 1922, to June 1st, 1925, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May 1922, the Producing Company shall notify the Refining Company in writing whether the Producing Company elects to accept for the period of three (3) years, beginning June 1, 1922, the price fixed as provided in sub-division A, Paragraph Five, hereof, or to accept for said period a price fixed as in said sub-division A, Paragraph Five, but with a variation in price of crude oil of seven cents (7c) per barrel for each variation of one cent (1c) in the average price of gasoline per gallon, and a variation of three and one-half cents (3½c) per barrel for each variation of one cent (1c) in the average price of Water White Kerosine Oil per gallon, and the Refining Company shall pay for Crude Oil in accordance with such election.

C—During the period from June 1, 1925, to June 1, 1928, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

125 On or before the first day of May, 1925, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in sub-division B of this paragraph Five, it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

D—During the period from June 1, 1928, to June 1, 1931, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May, 1928, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in subdivision B of this Paragraph Five it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

E—During the period from June 1, 1931, to January 1, 1934, the price to be paid by the Refining Company to the Producing Company for oil purchased by the Refining Company from the Producing Company shall be fixed and determined as follows:

On or before the first day of May, 1931, the Producing Company shall notify the Refining Company in writing which of the two options as to price set out in sub-division B of this paragraph Five,

it elects to accept, and the Refining Company shall pay for Crude Oil in accordance with such election.

It is understood that in no event shall the price paid for Crude Oil hereunder be less than sufficient to enable the said Producing Company to pay all the present existing royalties or charges upon oil produced in said lands.

Six: Payments for oil purchased by the Refining Company from the Producing Company shall be made to the Producing Company at the Producing Company's office on or before the twentieth day of the month succeeding the calendar month in which the oil is produced, provided one-third (⅓) of the total Salt Creek oil taken into the Casper refinery during the said calendar month, except the so-called "independent oil," shall be paid for and variations between such amount and the actual production of the Producing Company shall be adjusted and settled for at the end of each year of the contract, or sooneer if possible.

126 Seven: If at any time during the term of this contract the Government, either State or National, shall exact a royalty on any oil taken from the lands of the Producing Company, the Refining Company will either purchase from such Government said royalty oil or if the Producing Company has purchased said royalty oil the Refining Company will purchase it from the Producing Company at the price paid by the Producing Company for such royalty oil; provided, that the Refining Company shall be given the exclusive right to agree in behalf of the Production Company with the Government as to the price to be paid for such oil.

Eight: The Refining Company at all times shall operate said lands of the Producing Company in all proper and reasonable ways for the protection and conservation of the oil and gas content thereof, and for the production of the maximum amount of Crude Oil purchasable by the Refining Company hereunder. In the event that the drilling, production or conservation methods of the Refining Company shall not meet the approval of the Engineer who may be employed by the Directors on the Board of the Producing Company selected by Mary Dean Reed or her nominee, the said Engineer and the Engineer of the Refining Company shall select a third Engineer, and the decision of a majority of these three engineers on any point at issue shall prevail as to the future proceeding on such point. The Refining Company shall be furnished by the Producing Company with copies of all leases, contracts and written obligations pertaining to the operation of said lands, or any part thereof, and if in doubt as to the scope or meaning of such leases, contracts or obligations shall on request be advised by counsel of the Producing Company in respect thereto, and thereupon the Refining Company shall faithfully perform the terms of all such contracts and leases and sustain such obligations, except that the Refining Company shall not pay any royalties or charges which may be either now fixed upon said lands, or any part thereof, or may be hereafter arranged between said producing Company, as owner and occupant of said lands

or interest therein, and third parties for contracts affecting said lands, or as between the Producing Company as Lessee and its Lessors. From time to time the Producing Company shall notify the Refining Company in writing as to any and all assessment
127 work that should be performed on or in respect to any lands of the Producing Company and thereupon in due course the Refining Company will perform such assessment work and charge the cost thereof to the Producing Company.

Nine: This agreement shall extend to the titles to said lands of the Producing Company as at present held and as the titles may hereafter be perfected or altered in any way. The Refining Company shall always respect the titles to said lands and interests of the Producing Company and shall take no steps in any way prejudicial thereto; and on the other hand if for any reason or from any cause whatever the titles of the Producing Company are changed to any form or leasehold, deed or contract differing from the present nature or status of its ownership as to all or any part of said lands, whether greater or less in extent of title or estate, this contract shall extend to such titles in their changed or altered form and such titles and alterations thereof shall be subject hereto; provided however, that nothing herein contained shall be construed to limit the right of the Producing Company to adjust litigation or claims instituted or asserted by other persons affecting the property of the Producing Company, if any such litigation or claims there be, and the Refining Company shall release from the operation of this contract any lands covered hereby and necessary to be released in effecting such adjustment.

Ten: The Producing Company shall pay all expenses in connection with the maintenance and perfection of its own titles, including charges for assessment work.

Eleven: The Producing Company may at all times maintain Gaugers and Inspectors upon said lands and shall be furnished by the Refining Company with monthly statements showing:

(a)—The total amount of oil produced from the lands of the Producing Company.

(b)—The entire amount of oil being produced from the Salt Creek Oil Field (Wyoming), itemized as to the respective parcels of land from which said oil has been produced, so far as such information is reasonably accessible to the Refining Company.

128 (c)—The number of barrels of gasoline and Water White Kerosene Oil, respectively, sold by the Refining Company and the gross price received for each product.

Twelve: Performance shall be excused by acts of God, public enemies, strikes, fires, elemental disturbances, failure of oil supply, unavoidable accidents or causes beyond reasonable control; but subject to these causes only if the Refining Company fails to comply with any of the conditions and sustain all obligations imposed upon it hereby and such failure continues for a period of sixty (60) days after notice in writing to the Refining Company from the Producing

Company then the Producing Company may at once declare this contract forfeited and terminated, and without process of law may re-enter upon said premises as of its first and former estate; or, at the option of the Producing Company it may require the Refining Company to continue the operation, insisting upon full compliance by the Refining Company, and any acceptance by the Producing Company of performance less favorable than that to which it is entitled will constitute in no way a waiver of its full rights under the contract.

Thirteen: On the first day of January 1934 possession of all the lands of the Producing Company shall be returned to it by the Refining Company.

Fourteen: This contract shall inure to and be binding upon the successors and assigns of the respective parties hereto.

In Witness Whereof, the parties have caused their respective corporate names to be hereunto signed and their corporate seals to be affixed by their proper officers, thereunto duly authorized, in duplicate, at Denver, Colorado, on the day and year first above written.

By ——— ———

Attest:

THE MIDWEST REFINING COMPANY,

By ——— ———

Attest:

——— ———

129 (Continuation of Minutes of a Special Meeting of the Board of Directors of The Wyoming Associated Oil Corporation Held on the 18th day of July A. D. 1919.)

On motion, duly seconded and unanimously carried, it was,

Resolved, that in the opinion of the Board of Directors of this corporation, the conveyance to it of the properties covered by said proposal will constitute full consideration for the issuance of the entire authorized capital stock of this corporation and will render said stock fully paid and non-assessable.

Resolved, further, that the proposal submitted and read to the directors be, and it hereby is, accepted by this corporation, upon the terms and conditions therein set forth.

Resolved, further, that upon the delivery to this corporation of instruments of conveyance, assignment or transfer to it of the properties covered by said proposal, said instruments to be satisfactory to counsel for this corporation, the proper officers of this corporation be, and they hereby are, authorized to issue and deliver certificates for the total amount of authorized capital stock of this Company, to-wit, 350,000 shares, without nominal or par value, to the persons and corporations, and in the respective amounts, set forth in said proposal; and the Board hereby declares that said stock, when issued as aforesaid, shall be fully paid and non-assessable stock, and that the property

to be conveyed, assigned, or transferred to this Corporation, as provided in said proposal, shall likewise constitute full payment for the stock of this corporation subscribed by the original subscribers and incorporators. The question of the execution of the contract marked Exhibit A and attached to Exhibit 1 which is attached to the foregoing proposal, was then considered.

On motion, duly seconded and unanimously carried, it was:

Resolved, that the proper officers of this corporation be, and they hereby are, authorized and directed to execute and deliver, in the name and on behalf of this corporation, the contract in form and substance as set forth in said Exhibit A.

The Secretary thereupon reported to the meeting that on the 17th day of July 1919, a certified copy of the Certificate of Incorporation of the Corporation, a certified copy of the General Corporation
130 laws of the State of Delaware, an Acceptance of the Constitution of the State of Wyoming, and a Certificate establishing an office and appointing a resident agent in Wyoming, were duly filed with the Secretary of State of the State of Wyoming, and all necessary fees were paid for the purpose of qualifying said Corporation to do business in said State; and that on the same date certified copy of the Certificate of Incorporation and a certified copy of the General Corporation laws of Delaware were mailed to the County Clerk of Natrona County, Wyoming, for filing, together with a check to cover the filing fees.

No further business being presented to the meeting, on motion, duly seconded and unanimously carried, the meeting adjourned sine die.

J. L. WARREN, *Secretary.*

We hereby approve the foregoing minutes:

N. S. WILSON,
D. M. HARRINGTON,
F. C. ROBERTS,
VERNER Z. REED, Jr.,
J. L. WARREN,
Directors.

Exhibit L-2

DEED

Know All Men By These Presents, that the Salt Creek Producers Association, Incorporated, a corporation of the State of Virginia, in consideration of the sum of Ten ($10.00) Dollars and other good and valuable considerations to it in hand paid by The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, receipt whereof is hereby acknowledged, does hereby give, grant, bargain, sell, remise, release, quitclaim, assign, transfer, and convey unto said The Wyoming Associated Oil Corporation, and its successors and assigns forever, all its right, title, interest, estate, claim, and demand, as well in law as in equity, in or to the following described property situate in the County of Natrona, State of Wyoming, to-wit:

131 Group A

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South Half of the Northeast quarter (S½NE¼) of Section Ten (10);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Ten (10);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Ten (10);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Ten (10);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Eleven (11);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Eleven (11);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Eleven (11);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Eleven (11);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Thirteen (13);

* * * * * * *

Lot One (1) and the South Half of the Northeast Quarter (S½NE¼) of Section Two (2);

Lot Three (3) of Section Two (2) and the Southeast Quarter of the Northwest Quarter (SE¼NW¼) of Section Two (2) except the West seven (7) acres thereof;

132 The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Ten (10);

The East half of the Southeast quarter (E½SE¼) of Section Eleven (11);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Twelve (12);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Twelve (12);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Twelve (12);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Twelve (12);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Thirteen (13);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Thirteen (13);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Thirteen (13);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Twenty-four (24);

All the foregoing in Group D being in Township Thirty-nine (39) North, Range Seventy-nine (79) West of the Sixth Principal Meridian.

Also all the right, title, and interest of the above-named
133 grantor in or to the Northeast quarter of the Northeast quarter (NE¼NE¼); the South half of the Northeast quarter (S½NE¼); the Southeast quarter (SE¼); the Northeast quarter of the Southwest quarter (NE¼SW¼); and the South half of the Southwest quarter (S½SW¼) of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian, under a certain lease dated December 26, 1914, from the State of Wyoming to The Midwest Oil Company.

Together with all and singular the mines, minerals, oil, gas, petroleum and all forms of mineral deposit in or under the said premises and the rents, issues and profits therefrom and all fixtures, improvements, rights, hereditaments and appurtenances thereunto in any wise appertaining.

To Have and to Hold the premises above described with their tenements and appurtenances unto said The Wyoming Associated Oil Corporation and its successors and assigns forever.

In Witness Whereof said the Salt Creek Producers Association, Incorporated, has caused these presents to be signed in its corporate

name by its officers thereunto duly authorized and to be sealed with its corporate seal this 18th day of July, A. D. 1919.

SALT CREEK PRODUCERS ASSOCIATION, INCORPORATED,
By N. S. WILSON, *Its President.*

In the Presence of us as Witnesses:
PETER H. HOLME,
HAROLD D. ROBERTS.

Attest:

J. L. WARREN, *Secretary.* [SEAL]

DEED

Know All Men By These Presents, That Mary Dean Reed as executrix of the estate of Verner Z. Reed, deceased; Mary Dean Reed as guardian of the estate of Verner Z. Reed, Jr., a minor, and as guardian of the estate of Joseph Verner Reed, a minor, and Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed, as successors in trust to Verner Z. Reed, deceased, trustee under separate trusts for Margery Verner Reed, and for Verner Z. Reed, Jr., and for Joseph Verner Reed (all of said persons
134 in their several capacities being hereinafter referred to collectively as "grantors"), in consideration of the sum of ten ($10.00) dollars and other good and valuable considerations to each of them in hand paid by The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, receipt whereof is hereby acknowledged, do hereby severally give, grant, bargain, sell, remise, release, quitclaim, assign, transfer and convey unto said The Wyoming Associated Oil Corporation and its successors and assigns forever, all the rights, title, interest, estate, claim and demand, as well in law as in equity, which they or any of them may have or hold in or to the following described property, situate in the County of Natrona, State of Wyoming, to-wit:

GROUP A

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South Half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Northwest quarter ($NE\frac{1}{4}NW\frac{1}{4}$) and the South half of the Northwest quarter ($S\frac{1}{2}NW\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Southwest quarter ($NE\frac{1}{4}SW\frac{1}{4}$) and the South half of the Southwest quarter ($S\frac{1}{2}SW\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Eleven (11);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Eleven (11);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Eleven (11);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Eleven (11);

135 The Northeast quarter of the Northeast quarter (NE¼ NE¼) and the South half of the Northeast quarter. (S½ NE¼) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Thirteen (13);

* * * * * * *

The East half of the Southeast quarter (E½SE¼) of Section Eleven (11);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Twelve (12);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Twelve (12);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Twelve (12);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Twelve (12);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Thirteen (13);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Thirteen (13);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Thirteen (13);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Twenty-four (24);

All the foregoing in Group D being in Township Thirty-
136 nine (39) North, Range Seventy-nine (79) West of the Sixth Principal Meridian.

Also all the right, title and interest of the above-named grantors in and to or under a certain lease dated December 26, 1914, from the State of Wyoming to The Midwest Oil Company and covering all of Section Thirty-six (36), Township Forth (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian;

Together with all and singular the mines, minerals, oil, gas petroleum and all forms of mineral deposit in or under the said premises and the rents, issues and profits therefrom and all fixtures, improvements, rights, hereditaments and appurtenances thereunto in any wise appertaining.

To Have and to Hold the premises above described, with their appurtenances unto said The Wyoming Associated Oil Corporation and its successors and assigns forever.

In Witness Whereof said grantors have hereunto set their hands and affixed their seals this 18th day of July, A. D. 1919.

MARY DEAN REED, [SEAL]
As Executrix of the Estate of
Verner Z. Reed, deceased.

As to all signatures on this page,
In the Presence of us as Witnesses:
D. M. HARRINGTON,
J. E. TOOKER.

MARY DEAN REED, [SEAL]
As Guardian of the estate of Verner Z. Reed, Jr., as minor and as guardian of the estate of Joseph Verner Reed, a Minor.

MARY DEAN REED, [SEAL]
MARGERY VERNER REED, [SEAL]
VERNER Z. REED, JR., [SEAL]
JOSEPH VERNER REED, [SEAL]
As Successors in trust to Verner Z. Reed, deceased, trustee under separate trusts for Margery Verner Reed and for Verner Z. Reed., Jr., and for Joseph Verner Reed.

137 STATE OF COLORADO,
City and County of Denver, ss:

I, Lansing E. Rowland, a Notary Public in and for the City and County and State aforesaid, do hereby certify that Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed, who are personally known to me to be the same persons whose names are subscribed to the foregoing instrument in writing, appeared before me this day in person and severally acknowledged, each for himself and not one for another: That said Mary Dean Reed signed, sealed, and delivered said instrument in her capacity as executrix of the estate of Verner Z. Reed, deceased, and as guardian of the estate of Verner Z. Reed, Jr., a minor, and as guardian of the estate of Joseph Verner Reed, a minor, as her free and voluntary

act and deed in said several capacities, and for the uses and purposes therein set forth; and that Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed, signed, sealed, and delivered said instrument in their capacity of successors in trust to Verner Z. Reed, deceased, trustee under separate trusts for Margery Verner Reed for Verner Z. Reed, Jr., and for Joseph Verner Reed, as their free and voluntary act and deed in said capacity, and for the uses and purposes therein set forth.

Given under by hand and notarial seal this 18th day of July, A. D. 1919. My commission expires October 31st, 1920.

[SEAL] LANSING E. ROWLAND,
Notary Public.

DEED

Know All Men By These Presents, That we, Mary Dean Reed and Margery Verner Reed, both of the City and County of Denver, State of Colorado, in consideration of the sum of Ten ($10.00) Dollars and other good and valuable considerations to us in hand paid by The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, receipt whereof is hereby acknowledged, do hereby give, grant, bargain, sell, remise, release, quit-claim, assign, transfer, and convey unto said The Wyoming Associated Oil Corporation, and its successors and assigns forever, all the right, title, interest, estate, claim, and demand as well in law as in equity which we or either of us may have or hold in or to the following described property situate in the County of Natrona and State of Wyoming to-wit:

138 GROUP A

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South Half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Northwest quarter ($NE\frac{1}{4}NW\frac{1}{4}$) and the South half of the Northwest quarter ($S\frac{1}{2}NW\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Southwest quarter ($NE\frac{1}{4}SW\frac{1}{4}$) and the South half of the Southwest quarter ($S\frac{1}{2}SW\frac{1}{4}$) of Section Ten (10);

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Eleven (11);

The Northeast quarter of the Northwest quarter ($NE\frac{1}{4}NW\frac{1}{4}$) and the South half of the Northwest quarter ($S\frac{1}{2}NW\frac{1}{4}$) of Section Eleven (11);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Eleven (11);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Eleven (11);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Thirteen (13);

* * * * * * *

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Twenty-four (24);

All the foregoing in Group D being in Township Thirty-nine (39) North, Range Seventy-nine (79) West of the Sixth Principal Meridian.

139 Also all the right, title and interest in the above-named grantor in and to or under a certain lease dated December 26, 1914, from the State of Wyoming to the Midwest Oil Company and covering all of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian;

Together with all and singular the mines, minerals, oil, gas, petroleum and all forms of mineral deposit in or under the said premisis and the rents, issues and profits therefrom and all fixtures, improvements, rights, hereditaments and appurtenances thereunto in any wise appertaining.

To Have and to Hold the premises above described with their tenements and appurtenances unto said The Wyoming Associated Oil Corporation and its successors and assigns forever.

In Witness Whereof we, Mary Dean Reed and Margery Verner Reed, have hereunto set our hands and affixed our seals this 18th day of July, A. D. 1919.

MARY DEAN REED. [SEAL]
MARGERY VERNER REED. [SEAL]

Both signatures in the presence of us as witnesses:

D. M. HARRINGTON,
J. E. TOOKER.

STATE OF COLORADO,
City and County of Denver, ss:

I, Lansing E. Rowland, a Notary Public in and for the City and County and State aforesaid, do hereby certify that Mary Dean Reed and Margery Verner Reed, who are personally known to me to be the same persons whose names are subscribed to the foregoing instrument appeared before me this day in person and severally acknowledged that they signed, sealed and delivered the foregoing instrument in writing as their free and voluntary act and deed, for the uses and purposes therein set forth.

Given under my hand and notarial seal this 18th day of July, A. D. 1919. My commission expires October 31, 1920.

LANSING E. ROWLAND, [SEAL]
Notary Public.

140 Deed.

Know All Men by These Presents, That The Equitable Trust Company of New York, a corporation of the State of New York, as Trustee for Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed, under a certain Trust Agreement of October 4, 1900, and as Trustee for Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed under a certain Trust Agreement of August 23, 1902, in consideration of the sum of Ten ($10.00) Dollars and other good and valuable considerations to it in hand paid by The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, does hereby give, grant, bargain, sell, remise, release, quit-claim, assign, transfer and convey unto said The Wyoming Associated Oil Corporation, and its successors and assigns forever, all its right, title, interest, estate, claim or demand as well in law as in equity, in or to the following described property situate in Natrona County, Wyoming, to-wit:

GROUP A

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South Half of the Northeast quarter (S½NE¼) of Section Ten (10);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Ten (10);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Ten (10);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Ten (10);

The Northeast quarter of the Northeast quarter (NE¼NE¼) and the South half of the Northeast quarter (S½NE¼) of Section Eleven (11);

The Northeast quarter of the Northwest quarter (NE¼NW¼) and the South half of the Northwest quarter (S½NW¼) of Section Eleven (11);

141 The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Eleven (11);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Eleven (11);

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Thirteen (13);

* * * * * * *

($S\frac{1}{2}NE\frac{1}{4}$) of Section Two (2);

Lot Three (3) of Section Two (2) and the Southeast quarter of the Northwest quarter ($SE\frac{1}{4}NW\frac{1}{4}$) of Section Two (2), except the West Seven (7) acres thereof.

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Ten (10);

The East half of the Southeast quarter ($E\frac{1}{2}SE\frac{1}{4}$) of Section Eleven (11);

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Twelve (12);

The Northeast quarter of the Northwest quarter ($NE\frac{1}{4}NW\frac{1}{4}$) and the South half of the Northwest quarter ($S\frac{1}{2}NW\frac{1}{4}$) of Section Twelve (12);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Twelve (12);

The Northeast quarter of the Southwest quarter ($NE\frac{1}{4}SW\frac{1}{4}$) and the South half of the Southwest quarter ($S\frac{1}{2}SW\frac{1}{4}$) of Section Twelve (12);

142 The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Thirteen (13);

The Northeast quarter of the Northwest quarter ($NE\frac{1}{4}NW\frac{1}{4}$) and the South half of the Northwest quarter ($S\frac{1}{2}NW\frac{1}{4}$) of Section Thirteen (13);

The Northeast quarter of the Southeast quarter ($NE\frac{1}{4}SE\frac{1}{4}$) and the South half of the Southeast quarter ($S\frac{1}{2}SE\frac{1}{4}$) of Section Thirteen (13);

The Northeast quarter of the Southwest quarter ($NE\frac{1}{4}SW\frac{1}{4}$) and the South half of the Southwest quarter ($S\frac{1}{2}SW\frac{1}{4}$) of Section Thirteen (13);

The Northeast quarter of the Northeast quarter ($NE\frac{1}{4}NE\frac{1}{4}$) and the South half of the Northeast quarter ($S\frac{1}{2}NE\frac{1}{4}$) of Section Twenty-four (24);

All the foregoing is Group D being in Township Thirty-nine (39) North, Range Seventy-nine (79) West of the Sixth Principal Meridian.

Also all the right, title, and interest of the above-named grantor in and to or under a certain lease dated December 26, 1914, from the

State of Wyoming to The Midwest Oil Company covering all of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian;

Together with all and singular the mines, minerals, oil, gas, petroleum, and all forms of mineral deposit in or under the said premises and the rents, issues, and profits therefrom and all fixtures, improvements, rights, hereditaments, and appurtenances thereunto in any wise appertaining.

To Have and to Hold the premises above described, with their tenements and appurtenances unto said The Wyoming Associated Oil Corporation and its successors and assigns forever.

In Witness Whereof said The Equitable Trust Company of New York as trustee under the trusts aforesaid has caused these
143 presents to be executed in its corporate name by its officers thereunto duly authorized and to be sealed with its corporate seal this 14th day of July A. D. 1919.

THE EQUITABLE TRUST COMPANY,
OF NEW YORK, *Trustee.*
By J. N. BABCOCK, *Vice President.*

In the presence of us as witnesses:
J. L. KEMPF.
J. T. HELMSTADT.
Attest:

W. J. ECK. [SEAL]

STATE OF NEW YORK,
County of New York, ss:

I, Frederick C. Moller, a Notary Public in and for the County and State aforesaid, do hereby certify that J. N. Babcock and W. J. Eck, who are personally known to me to be the same persons whose names are subscribed to the foregoing instrument as the Vice President and Secretary, respectively, of The Equitable Trust Company of New York, appeared before me this day in person and severally acknowledged: That the said J. N. Babcock is the Vice President of said corporation and that the said W. J. Eck is the Secretary thereof, that the seal affixed on the foregoing instrument is the corporate seal of said corporation; that the same was directed to be affixed by authority of said corporation; that by authority of said corporation they respectively signed their names thereto as Vice President and Secretary; and that they signed, sealed, and delivered said instrument as their free and voluntary act and deed, and as the free and voluntary act and deed of said corporation in its capacity to trustee for Mary Dean Reed, Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed under a certain trust agreement of October 4, 1900, and as trustee for Margery Verner Reed, Verner Z. Reed, Jr., and Joseph Verner Reed under a certain trust agreement of August 23, 1902, and for the uses and purposes therein set forth.

Given under by hand and notarial seal this 14th day of July, A. D. 1919. My notarial commission expires March 30, 1921.

FREDERICK C. MOLLER,
Notary Public.

Notary Public Richmond Co., No. 143. Certificate filed in New York Co., No. 267. Register's Office No. 1319. Term expires March 30, 1921.

144 DEED

Know All Men By These Presents, That The California Oil Company, a corporation organized and existing under and by virtue of the laws of the State of Arizona, in consideration of the sum of Ten ($10.00) Dollars and other good and valuable considerations to it in hand paid by The Wyoming Associated Oil Corporation, a corporation organized and existing under and by virtue of the laws of the State of Delaware, receipt whereof is hereby acknowledged, does hereby give, grant, bargain, sell, remise, release, quitclaim, and convey unto said The Wyoming Associated Oil Corporation, and its successors and assigns forever, all its right, title, interest estate, claim, or demand as well in law as in equity, in or to the following described property situate in Natrona County, Wyoming, to-wit:

The East half of the Northeast quarter (E½NE¼) of Section Twenty-five (25);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Twenty-five (25);

The Southwest quarter of the Northeast quarter (SW¼NE¼) of Section Twenty-Six (26);

The Southwest quarter of the Northwest quarter (SW¼NW¼) of Section Twenty-six (26);

The Northeast quarter of the Southeast quarter (NE¼SE¼) and the South half of the Southeast quarter (S½SE¼) of Section Twenty-six (26);

The Northeast quarter of the Southwest quarter (NE¼SW¼) and the South half of the Southwest quarter (S½SW¼) of Section Twenty-six (26);

All the foregoing being situate in Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian;

Also all the right, title, and interest of the above-named grantor in, to, or under a certain lease dated December 26, 1914, from the State of Wyoming to The Midwest Oil Company, and covering all of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian.

145 Together with all and singular the mines, minerals, oil, gas, petroleum, and all forms of mineral deposit in or under the said premises, and all fixtures, improvements, rights, hereditaments thereunto in any wise appertaining.

To Have and to Hold the premises above described with their tenements and appurtenances unto said The Wyoming Associated Oil Corporation and its successors and assigns forever.

In Witness Whereof said The California Oil Company has caused these presents to be executed in its corporate name by its officers thereunto duly authorized and to be sealed with its corporate seal this 18th day of July A. D. 1919.

THE CALIFORNIA OIL COMPANY,
By (Signed) MARY DEAN REED, *President.*

In the presence of us as witnesses:

(Signed) D. M. HARRINGTON.
(Signed) J. E. TOOKER.

Attest:

(Signed) C. E. TITUS, *Secretary.* [Seal.]

STATE OF COLORADO,
City and County of Denver, ss:

I, Lansing E. Rowland, a Notary Public in and for the City and County and State aforesaid, do hereby certify that Mary Dean Reed and C. E. Titus, who are personally known to me to be the President and Secretary, respectively, of The California Oil Company, appeared before me this day in person and severally acknowledged that the said Mary Dean Reed is the President of said corporation and that the said C. E. Titus is the Secretary thereof; that the seal affixed to the foregoing instrument is the corporate seal of said corporation; that the same was thereunto affixed by authority of said corporation and that by authority of said corporation they respectively subscribed their names thereto as President and Secretary, and that they signed, sealed, and delivered the said instrument as their free and voluntary act and deed, and as the free and voluntary act and deed of said corporation for the uses and purposes therein set forth.

Given under my hand and Notarial Seal this 18th day of July A. D. 1919. My commission expires October 31, 1920.

(Signed) LANSING E. ROWLAND, [SEAL]
Notary Public.

146 *Exhibit N*

DECLARATION OF TRUST

Know All Men by These Presents:

That Whereas The Midwest Oil Company, a corporation of the State of Arizona, is the holder of a certain lease from the State of Wyoming, dated the 1st day of October 1919, and covering all of section thirty-six (36), Township forty (40) North, Range seventy-nine (79) west, in Natrona County, Wyoming, containing six hundred forty (640) acres, more or less; and

Whereas The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, is entitled to receive the undivided share in

the benefits and net proceeds realized by The Midwest Oil Company, under said lease and all renewals and extensions thereof, as hereinafter set forth;

Now, Therefore, In consideration of the premises and in consideration of other good and valuable considerations paid to The Midwest Oil Company by the Wyoming Associated Oil Corporation, said The Midwest Oil Company doth hereby declare that it holds an undivided fifty per cent (50%) interest in said lease and in the benefits and net proceeds to be realized therefrom and all renewals and extensions thereof for the use and benefit of said The Wyoming Associated Oil Corporation, and reserves the beneficial interest in the remaining fifty per cent (50%) thereof to itself.

And in consideration of the creation of the foregoing trust, said The Wyoming Associated Oil Corporation hereby covenants that it will share all of the burdens and obligations hereafter accruing under said lease with The Midwest Oil Company in the fractions hereinabove set forth, and that in the event any renewal or extensions of said lease should be made in the name of The Wyoming Associated Oil Corporation, or in their joint names, then the interest thereunder shall be held by the recipient of said lease in trust for the benefit of itself and the other party hereto in the fractions hereinabove set forth.

It is mutually agreed that this assignment shall be effective as of the first day of February 1923, and that production of oil and gas from said land on and after said first day of February shall be divided in accordance herewith.

147 And for the consideration aforesaid, The Wyoming Associated Oil Corporation hereby consents to this declaration of trust and agrees that for the period beginning February 1, 1923, this declaration of trust shall completely supersede and replace all other declarations and definitions of interest in favor of said The Wyoming Associated Oil Corporation.

In Witness Whereof Said The Midwest Oil Company, and said The Wyoming Associated Oil Corporation have caused these presents to be executed by the respective officers thereunto duly authorized this First day of February 1923.

THE MIDWEST OIL COMPANY,

[SEAL] (Signed) By A. D. AITKEN,
Vice President.

Witness:
(Signed) L. G. CROSIER.

Attest:
(Signed) H. H. BROOKS, *Secretary.*

THE WYOMING ASSOCIATED OIL CORPORATION,

[SEAL] (Signed) By JOHN T. BARNETT, *President.*

Witness:
(Signed) G. E. MURRAY.

Attest:
(Signed) J. L. WARREN, *Secretary.*

Exhibit T–1

AGREEMENT

This Agreement Made as of the First day of February, A. D. 1923, between The Midwest Oil Company, a corporation of the State of Arizona, and Wyoming Oil Fields Company, a corporation of the State of Wyoming, and The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, parties of the first part, hereinafter called the "Producing Companies," and The Midwest Refining Company, a corporation of the State of Maine, party of the second part, hereinafter called the "Refining Company"; Witnesseth:

Whereas The Producing Companies among them own in the several fractions hereinafter set forth leases covering the following described lands in the Salt Creek Oil Field, Natrona County, Wyoming, to-wit:

The so-called "Schoonmaker Lease," covering the West Half
148 (W½) of Section Twelve (12), the Northwest Quarter (NW¼) and the North Half of the Southwest Quarter (N½SW¼) of Section Thirteen (13), Township Forty (40) North, Range Seventy-nine (79) West, owned an undivided 50 per cent by The Midwest Oil Company and an undivided 50 per cent by The Wyoming Associated Oil Corporation;

The so-called "Iba Lease," covering the South Half of the Southwest Quarter (S½SW¼) of Section Thirteen (13), Township Forty (40) North, Range Seventy-nine (79) West, owned an undivided 50 per cent by The Wyoming Associated Oil Corporation and an undivided 50 per cent by Wyoming Oil Fields Company;

The so-called "Stock Lease," covering the East Half (E½) of Section Twenty-five (25), Township Forty (40) North, Range Seventy-nine (79) West, owned an undivided 50 per cent by The Midwest Oil Company and an undivided 50 per cent by The Wyoming Associated Oil Corporation;

The so-called "State School Lease," covering all of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West, held in trust by The Midwest Oil Company for the benefit of The Midwest Oil Company to the extent of an undivided 50 per cent interest and for the benefit of The Wyoming Associated Oil Corporation to the extent of an undivided 50 per cent interest.

ARTICLE I

Now, Therefore, In consideration of One Dollar ($1.00) and other good and valuable considerations to them in hand paid by the Refining Company and of the agreements of the Refining Company, hereinafter set forth, the said Producing Companies hereby covenant and agree as follows, to-wit:

SECTION 1. From the date of this contract until the First day of January 1934 the Producing Companies will sell, exclusively, unto the Refining Company all of their oil produced and saved from the above-mentioned lands (except oil used on the lands for drilling,

domestic or production purposes) upon a sliding scale of prices fixed by calendar monthly periods as follows:

(A) When the average price received by the Refining Company for gasoline sold from its Casper, Wyoming, Refinery during any
149 month is 18 cents per gallon and the average price received by it for water white kerosene oil from said refinery during each month is 7½ cents per gallon, then the price of crude oil sold and purchased during said month, under this Agreement, shall be the base price of $1.42½ per barrel of forty-two (42) gallons. If the average price so received for gasoline shall be more or less than 18 cents per gallon, then for each cent increase over or decrease under said sum of 18 cents there shall be added to or subtracted from said base price 5 cents per barrel, and if the average price so received for water white kerosene oil shall be more or less than 7½ cents per gallon, then for each cent increase over or decrease under said sum of 7½ cents, there shall be added to or subtracted from said base price the sum of 2½ cents per barrel. Increases or decreases of less than one (1) cent in the price received for either gasoline or water white kerosene oil shall result in proportionate adjustments of price.

(B) On or before the First day of May 1925 the Producing Companies shall have the right to notify the Refining Company in writing whether the Producing Companies elect to accept for the period of three (3) years, beginning June 1, 1925, the price fixed as provided in sub-division A hereof, or to accept for said period a price fixed in the same manner except for a variation in the price of crude oil of 7 cents per barrel for each variation of one (1) cent in the average price per gallon received for gasoline and a variation of 3½ cents per barrel for each variation of one (1) cent in the average prices per gallon received for water white kerosene oil, and the Refining Company shall pay the Producing Companies for crude oil in accordance with such election, or if no election is made, shall pay the Producing Companies for crude oil in accordance with subdivision A hereof.

(C) On or before the first day of May 1928 the Producing Companies shall have the right to notify the Refining Companies in writing which of the two options as to price set out in sub-division B hereof they elect to accept, and the Refining Company shall pay for crude oil in accordance with such election for the period from June 1, 1928, to June 1, 1931, or if no such election is made, shall pay for crude oil in accordance with sub-division A hereof.

(D) On or before the first day of May 1931 said Producing Companies shall have the right to notify the Refining Company, in
150 writing, which of the two options, as to price set out in sub-division B hereof, they elect to accept, and the Refining Company shall pay for crude oil in accordance with such election for the period from June 1, 1931, to January 31, 1934, or if no such election is made, shall pay for crude oil in accordance with sub-division A hereof.

SECTION 2. From the date of this Agreement until the first day of January 1934 the Producing Companies will give the Refining Com-

pany free use of all storage facilities, pipe lines, buildings, and equipment owned by the Producing Companies, or either of them, upon said lands, and will also give, free of charge, so much of the oil and gas produced as may be reasonably necessary for drilling, domestic service, and production on said lands.

ARTICLE II

In Consideration of One Dollar ($1.00) and other good and valuable considerations to it in hand paid by the Producing Companies, and of the agreements of the Producing Companies hereinabove set forth, the Refining Company hereby covenants and agrees as follows, to-wit:

SECTION 1. From the date of this agreement until the first day of January 1934 the Refining Company will purchase from the several Producing Companies currently as produced all of the oil of the several Producing Companies produced and saved from said lands at the price or prices fixed by the provisions of Section 1 of Article I hereof, excepting only oil reasonably used on the land in connection with drilling, domestic, or production purposes on said lands.

SECTION 2. From the date of this Agreement until the first day of January 1934, as part of the price for oil purchased hereunder, the Refining Company will drill, case, and maintain all wells, find and supply water, install and operate pumps when necessary, clean, shoot, and otherwise stimulate production of wells as necessary, and conduct all development and production operations upon said lands necessary or proper for the protection and conservation of the oil and gas contained therein and for the production of oil thereform in such amounts and from such wells as will prevent the drainage of the oil content of said lands through wells belonging to other operators, and will, at all times, during said term, maintain the development of and production from said lands at such rate that the production of oil
151 therefrom shall be proportionate to the production of oil in other parts of the Salt Creek Field. (The term Salt Creek Field as herein used shall not be deemed to include the lands contained within Naval Reserve No. 3.)

ARTICLE III

The parties hereto mutually agree as follows:

SECTION 1. Separate settlements between each of the Producing Companies and the Refining Company shall be made on or before the 20th day of each month in respect to all oil of the particular Producing Company produced during the calendar month preceding.

SECTION 2. The Refining Company will take delivery of the oil purchased hereunder at the outlet gates of the measuring tanks located at or near the wells on said lands. In the measurement of oil, there shall be allowed a deduction of three per cent (3%) for moisture and basic sludge, unless, at any time, the Refining Company shall establish a rule in the Salt Creek Field for a less deduction in the measurement of oil purchased from other producers, in which

event, such smaller deduction shall be applicable to the measurement of oil purchased hereunder. In the event the production from any well shall contain excessive quantities of water or be an emulsion of oil and water, then such production may be steamed for the separation of water and the oil shall be measured after steaming.

SECTION 3. It is understood that one of the tracts of land covered hereby, to-wit: Section Thirty-six (36) is subject to royalties in favor of the State of Wyoming, and that the other tracts of land are severally subject to various royalties in favor of others, and it is agreed that whenever the State of Wyoming, or any other royalty owner having the right to take his royalty in kind shall elect to exercise such right, then the royalty oil, with respect to which such right is exercised, shall not be subject to this purchase agreement, but shall be delivered by the Refining Company to such royalty owner in accordance with such directions as the royalty owner may rightfully give therefor, but the Refining Company shall have the right, if it and royalty owner can reach an agreement, to purchase any such royalty oil from the owner thereof on any terms mutually agreeable to them.

SECTION 4. The erection and maintenance of suitable flow lines, measuring tanks and gas traps for the separation and
152 collection of gas shall be included within the duties of the Refining Company in connection with the production of oil hereunder.

SECTION 5. The Producing Companies may at all times, maintain gaugers and inspectors upon their said lands, and shall be furnished by the Refining Company with monthly statements showing (a) total amount of oil produced from said lands, (b) the entire amount of oil being produced from the Salt Creek Field itemized as to the respective parcels of land from which said oil is produced, so far as such information is reasonably accessible to the Refining Company, (c) the number of barrels of gasoline and water white kerosene oil, respectively, sold by the Refining Company from its Casper, Wyoming, refinery, and the gross price received for each product.

SECTION 6. In the event the drilling, production, or conservation methods of the Refining Company shall not meet the approval of the Producing Company, then the Producing Companies shall select an engineer, who, together with an engineer selected by the Refining Company, and a third engineer to be selected by these two engineers, jointly, shall investigate and decide upon the method, policy, or practice to be followed by the Refining Company, and the Refining Company shall comply with such decision. The Producing Companies will furnish the Refining Company with copies of all leases, contracts, and written obligations pertaining to the operation of said lands, or any parts thereof, and the Refining Company shall conduct its operation in such manner as to comply with all conditions and provisions thereof, and if in doubt as to the scope or meaning of any such leases, contracts, or obligations, it shall, upon request, be advised in respect thereto by the counsel of the Producing Companies, and thereupon

the Refining Company shall faithfully perform the terms of all such contracts and leases. The Refining Company, however, shall not, except by mutual agreement, pay any royalties or charges which may be either now or hereafter fixed upon said lands.

SECTION 7. This Agreement shall terminate at noon on January 1, 1934, and the Producing Companies shall, thereupon, assume full control of all drilling and producing operations thereon. The Refining Company shall have the right, for a reasonable time thereafter,
153 to remove all warehouses, storage tanks, structures, and other equipment, but the Refining Company shall not remove any casing or flow lines from producing wells, or pumps, pumphouses or pumping plants connected with pumping wells or any water or gas lines used for domestic or producing purposes, or any other material, structures, or equipment, including measuring tanks connected with or necessary for the continued production from said lands, all of which shall, without further payment, thereupon become the property of the Producing Companies. It is expressly understood that the oil pipe line system including the gathering lines, field storage, pumping stations and equipment, telegraph and telephone lines, the main water trunk line from Salt Creek to the main distributing point in the field, and the casinghead gas system, including its collecting lines, the casinghead plants and the gasoline lines to Casper are and shall continue to be the property of the Refining Company, and that upon the termination of this Agreement, the Refining Company shall have the rights, without charge, to continue to operate the same so long as the Producing Companies shall hold said lands under their leases or any renewals or extensions thereof and that during such time, the Refining Company may occupy so much of said lands with its said structures and equipment as may be necessary for its operations. Such occupation of the Refining Company, however, shall not unreasonably interfere with the drilling of wells and production of oil from said land.

SECTION 8. In the event any of the leases under which the lands covered hereby are held should expire or terminate prior to January 1, 1934, and none of said Producing Companies should receive an extension, renewal, or new lease thereon, then upon such expiration or termination, this Agreement shall cease with respect to such particular tract or tracts of land and shall remain in full force and effect, as to the tracts of land remaining to the Producing Companies or any of them.

SECTION 9. Performance shall be excused by acts of God, public enemies, strikes, fires, elemental disturbances, failure of oil supply, unavoidable accidents, or causes beyond reasonable control, but subject to these causes only, if the Refining Company fails to comply with any of the conditions and sustain all obligations imposed upon it hereby, and such failure continues for a period of sixty days
154 after notice in writing to the Refining Company, then the Producing Companies may at once by joint action declare this contract forfeited and terminated, and may thereupon assume exclusive control of all operations upon the said premises, or at their option may

require the Refining Company to continue the operation, insisting upon full compliance by the Refining Company, and any acceptance by the Producing Companies of performance less favorable than that to which they are entitled will constitute in no way a waiver of their full rights under this Agreement. In the event of forfeiture of this Agreement, the Refining Company shall have the right to remove the property authorized to be removed under the preceding paragraph hereof.

SECTION 10. This contract shall bind and all its benefits shall accrue to the successors and assigns of both parties hereto.

In Witness Whereof The parties hereto have caused this Agreement to be executed by their duly authorized officers and their corporate seals to be hereunto affixed the day and year first above written.

THE MIDWEST OIL COMPANY,
By A. D. AITKEN, *Vice President.*

Attest:

H. H. BROOKS, *Secretary.* [SEAL]

WYOMING OIL FIELDS COMPANY,
By A. D. AITKEN, *Vice President.*

Attest:

H. H. BROOKS, *Secretary.* [SEAL]

THE WYOMING ASSOCIATED OIL CORPORATION,
By JOHN T. BARNETT, *President,*
Parties of the First Part.

Attest:

J. L. WARREN, *Secretary.* [SEAL]

THE MIDWEST REFINING COMPANY,
By T. A. DINES, *President,*
Party of the Second Part.

Attest:

T. A. PEDLEY, *Secretary.* [SEAL]

7-3-23/7s

155 *Exhibit T-2*

AGREEMENT

This Agreement Made as of the first day of February, A. D. 1923, between the Wyoming Associated Oil Corporation, a corporation of the State of Delaware, party of the first part, hereinafter called the "Producing Company," and the Midwest Refining Company, a corporation of the State of Maine, party of the second part, hereinafter called the "Refining Company"; Witnesseth;

Whereas The Producing Company is the owner of certain Government Oil and Gas Leases or Permits issued under the Act of February 25, 1920, covering in the aggregate those certain lands in the Salt Creek Oil Field, Natrona County, Wyoming, more fully described and set out on Schedule A hereto attached and hereby made a part hereof;

ARTICLE I

Now, Therefore, In consideration of One Dollar ($1.00) and other good and valuable considerations to it in hand paid by the Refining Company, and of the agreements of the Refining Company hereinafter set forth, the said Producing Company hereby covenants and agrees as follows, to-wit:

SECTION 1. From the date of this contract until the first day of January 1934 the Producing Company will sell, exclusively, unto the Refining Company, all of its oil produced and saved from the above mentioned lands (except oil used on the lands for drilling, domestic, or production purposes) upon a sliding scale of prices fixed by calendar monthly periods as follows:

(A) When the average price received by the Refining Company for gasoline sold from its Casper, Wyoming, Refinery during any month is 18c per gallon and the average price received by it for water white kerosene oil from said refinery during such month is 7½c per gallon, then the price of crude oil sold and purchased during said month under this Agreement shall be the base price of $1.42½ per barrel of forty-two (42) gallons. If the average price so received for gasoline shall be more or less than 18c per gallon, then for each cent increase over or decrease under said sum of 18c there shall be added to or subtracted from said base price 5c per barrel, and if the average
156 price so received for water white kerosene oil shall be more or less than 7½c per gallon, then for each cent increase over or decrease under said sum of 7½c there shall be added to or subtracted from said base price the sum of 2½c per barrel. Increases or decreases of less than 1c in the price received for either gasoline or water white kerosene oil shall result in proportionate adjustments of price.

(B) On or before the First day of May 1925 the Producing Company shall have the right to notify the Refining Company in writing whether the Producing Company elects to accept for the period of three (3) years, beginning June 1, 1925, the price fixed as provided in subdivision A hereof, or to accept for said period a price fixed in the same manner, except for a variation in the price of crude oil of 7c per barrel for each variation of 1c in the average price per gallon received for gasoline, and a variation of 3½c per barrel for each variation of 1c in the average prices per gallon received for water white kerosene oil, and the Refining Company shall pay the Producing Company for crude oil in accordance with such election, or if no election is made, shall pay the Producing Company for crude oil in accordance with subdivision A hereof.

(C) On or before the First day of May 1928 the Producing Company shall have the right to notify the Refining Company in writing which of the two options as to price set out in subdivision B hereof it elects to accept, and the Refining Company shall pay for crude oil in accordance with such election for the period from June 1, 1928, to June 1, 1931, or if no such election is made, shall pay for crude oil in accordance with subdivision A hereof.

(D) On or before the First day of May 1931 said Producing Company shall have the right to notify the Refining Company, in writing, which of the two options as to price set out in subdivision B hereof it elects to accept, and the Refining Company shall pay for crude oil in accordance with such election for the period from June 1, 1931, to January 31, 1934, or if no such election is made, shall pay for crude oil in accordance with subdivision A hereof.

SECTION 2. From the date of this Agreement until the First day of January 1934 the Producing Company will give the Refining Company free use of all storage facilities, pipe lines, buildings, and
157 equipment owned by the Producing Company upon said lands and will also give, free of charge, so much of the oil and gas produced as may be reasonably necessary for drilling, domestice service, and production on said lands.

ARTICLE II

In Consideration of One Dollar ($1.00) and other good and valuable considerations to it in hand paid by the Producing Company, and of the agreements of the Producing Company hereinabove set forth, the Refining Company hereby covenants and agrees as follows, to-wit:

SECTION 1. From the date of this Agreement until the First day of January, 1934, the Refining Company will purchase from the Producing Company currently as produced all of the oil of the Producing Company produced and saved from said lands, excepting only oil reasonably used on the land in connection with drilling, domestic, or production purposes on said land at the price or prices fixed by the provisions of Section 1 of Article I hereof.

SECTION 2. From the date of this Agreement until the First day of January, 1934, as part of the price for oil purchased hereunder, the Refining Company will drill, case, and maintain all wells, find and supply water, install and operate pumps when necessary, clean, shoot, and otherwise stimulate production of wells as necessary, and conduct all development and production operations upon said lands necessary or proper for the protection and conservation of the oil and gas contained therein and for the production of oil therefrom in such amounts and from such wells as will prevent the drainage of the oil content of said lands through wells belonging to other operators, and will, at all times during said term, maintain the development of and production from said lands at such rate that the production of oil therefrom shall be proportionate to the production of oil in other parts of the Salt Creek Field. (The term Salt Creek Field as herein used shall not be deemed to include the lands contained within Naval Reserve No. 3.)

ARTICLE III

The parties hereto mutually agree as follows:

SECTION 1. Settlements for oil sold and purchased hereunder
158 shall be made on or before the 20th day of each month in respect to all oil produced during the calendar month preceding.

SECTION 2. The Refining Company will take delivery of the oil purchased hereunder at the outlet gates of the measuring tanks located at or near the wells on said lands. In the measurement of oil, there shall be allowed a deduction of three per cent (3%) for moisture and basic sludge, unless at any time the Refining Company shall establish a rule in the Salt Creek Field for a less deduction in the measurement of oil purchased from other producers, in which event such smaller deduction shall be applicable to the measurement of oil purchased hereunder. In the event the production from any well shall contain excessive quantities of water or be an emulsion of oil and water, then such production may be steamed for the separation of water and the oil shall be measured after steaming.

SECTION 3. It is understood that the lands covered hereby are all subject to royalties in favor of the United States, and that many tracts of land are also subject to royalties in favor of others, and it is agreed that whenever the United States or any other royalty owner having the right to take his royalty in kind shall elect to exercise such right, then the royalty oil with respect to which such rights are exercised shall not be subject to this purchase agreement, but shall be delivered by the Refining Company to such royalty owner in accordance with such directions as the royalty owner may rightfully give therefor, but the Refining Company shall have the right, if it and the royalty owner can reach an agreement, to purchase any such royalty oil from the owner thereof on any terms mutually agreeable to them.

SECTION 4. The election and maintenance of suitable flow lines, measuring tanks, and gas traps for the separation and collection of gas shall be included within the duties of the Refining Company in connection with the production of oil hereunder.

SECTION 5. The Producing Company may at all times maintain gaugers and inspectors upon its said lands, and shall be furnished by the Refining Company with monthly statements showing (a) total amount of oil produced from said lands, (b) the entire amount of oil being produced from the Salt Creek Field itemized as to the
159 respective parcels of land from which said oil is produced, so far as such information is reasonably accessible to the Refining Company; (c) the number of barrels of gasoline and water white kerosene oil, respectively, sold by the Refining Company from its Casper, Wyoming, Refinery, and the gross price received for each product.

SECTION 6. In the event the drilling, production, or conservation methods of the Refining Company shall not meet the approval of the Producing Company, then the Producing Company shall select an engineer, who, together with an engineer selected by the Refining Company, and a third engineer to be selected by these two engineers, jointly, shall investigate and decide upon the method, policy, or practice to be followed by the Refining Company, and the Refining Company shall comply with such decision. The Producing Company will furnish the Refining Company with copies of all leases, contracts, and written obligations pertaining to the operation of said lands or any parts thereof, and the Refining Company shall conduct its operation in such manner as to comply with all conditions and provisions thereof, and if in doubt as to the scope or meaning of any such leases, contracts, or obligations, it shall, upon request, be advised in respect thereto by the counsel of the Producing Company, and thereupon the Refining Company shall faithfully perform the terms of all such contracts and leases. The Refining Company, however, shall not, except by mutual agreement, pay any royalties or charges which may be either now or hereafter fixed upon said lands.

SECTION 7. This Agreement shall terminate at noon on January 1, 1934, and the Producing Company shall thereupon assume full control of all drilling and producing operations thereon. The Refining Company shall have the right for a reaso'able time thereafter to remove all warehouses, storage tanks, structures, and other equipment, but the Refining Company shall not remove any casing or flow lines from producing wells, or pumps, pumphouses, or pumping plants connected with pumping wells, or any water or gas lines used for domestic or producing purposes, or any other material, structures, or equipment, including measuring tanks connected with or necessary for the continued production from said lands, all of which shall, without further payment, thereupon become the property of the Producing Company. It is expressly understood that the oil
160 pipe line system, including the gathering lines, field storage, pumping stations and equipment, telegraph and telephone lines, the main water trunk line from Salt Creek to the main distributing point in the field, and the casinghead gas system, including its collecting lines, the casinghead plants and the gasoline lines to Casper are and shall continue to be the property of the Refining Company, and that upon the termination of this Agreement, the Refining Company shall have the rights, without charge, to continue to operate the same so long as the Producing Company shall hold said lands under their lease or any renewals or extensions thereof, and that during such time the Refining Company may occupy so much of said lands with its said structures and equipment as may be necessary for its operations. Such operation of the Refining Company, however, shall not unreasonably interfere with the drilling of wells and production of oil from said land.

SECTION 8. Performance shall be excused by acts of God, public enemies, strikes, fires, elemental disturbances, failure of oil supply

unavoidable accidents, or causes beyond reasonable control, but subject to these causes only, if the Refining Company fails to comply with any of the conditions and sustain all obligations imposed upon it hereby, and such failure continues for a period of sixty days after notice in writing to the Refining Company, then the Producing Company may at once by its option declare this contract forfeited and terminated, and may thereupon assume exclusive control of all operations upon the said premises, or at its option may require the Refining Company to continue the operation, insisting upon full compliance by the Refining Company, and any acceptance by the Producing Company of performance less favorable than that to which it is entitled will in no way constitute a waiver of its full rights under this Agreement. In the event of forfeiture of this Agreement, the Refining Company shall have the right to remove the property authorized to be removed under the preceding paragraph hereof.

SECTION 9. This sales contract shall be construed in connection with the provisions of the Act of Congress of February 25, 1920, commonly known as the Lansing Act, and shall not be deemed to authorize any practice or operation upon or affecting the lands covered hereby in conflict with said Act or in conflict with the leases under which
161 said lands are held or the rules and regulations of the Department of the Interior applicable thereto.

SECTION 10. This contract shall bind and all its benefits shall accrue to the successors and assigns of both parties hereto.

In Witness Whereof The parties hereto have caused this Agreement to be executed by their duly authorized officers and their corporate seals to be hereunto affixed the day and year first above written.

[CORPORATE SEAL] THE WYOMING ASSOCIATED OIL CORPORATION,
(Sgd.) By JOHN T. BARNETT, *President.*

Attest:

(Sgd.) J. L. WARREN, *Secretary.*

[CORPORATE SEAL] THE MIDWEST REFINING COMPANY,
By T. A. DINES, *President.*

Attest:

(Sgd.) T. A. PEDLEY, *Secretary.*

Schedule A—Group A

The Northwest Quarter of the Northwest Quarter (NW¼NW¼), the South Half of the Northwest Quarter (S½NW¼), the Northwest Quarter of the Southeast Quarter (NW¼SE¼), the South Half of the Southeast Quarter (S½SE¼) and the Southwest Quarter (SW¼) of Section Fourteen (14);

The Northeast Quarter (NE¼), and the East Half of the Northeast Quarter of the Southeast Quarter (E½NE¼SE¼) of Section Fifteen (15);

The South Half of the Southeast Quarter (S½SE¼) of Section Twenty-two (22);

The East Half of the Northeast Quarter (E½NE¼), the Northeast Quarter of the Southeast Quarter (NE¼SE¼), the Southwest Quarter of the Southeast Quarter (SW¼SE¼), and the South Half of the Southwest Quarter (S½SW¼) of Section Twenty-three (23);

The North Half (N½), the North Half of the Southeast Quarter (N½SE¼) and the North Half of the Southwest Quarter (N½SW¼) of Section Twenty-four (24);

162 The South Half of the Southwest Quarter (S½SW¼) of Section Twenty-five (25);

The Northwest Quarter (NW¼), the West Half of the Northeast Quarter (W½NE¼), the South Half of the Southeast Quarter (S½SE¼), and the South Half of the Southwest Quarter (S½SW¼) of Sectio Twenty-six (26);

The North Half of the Northeast Quarter (N½NE¼) of Section Twenty-seven (27);

The South Half of the Northwest Quarter (S½NW¼), the South Half of the Northeast Quarter (S½NE¼), the North Half of the Southeast Quarter (N½SE¼) and the North Half of the Southwest Quarter of the Southeast Quarter (N½SW¼SE¼) of Section Thirty-four (34);

The Northwest Quarter (NW¼) and the Southeast Quarter (SE¼) of Section Thirty-five (35);

All of said land described in Group A being in Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian, in Natrona County, Wyoming.

GROUP B

Lot Two (2) in the Northwest Quarter (NW¼) of Section Nineteen (19);

Lot One (1) and Lot Two (2) in the Northwest Quarter (NW¼), the West Half of the Southeast Quarter (W½SE¼), the East Half of the Southwest Quarter (E½SW¼), and Lot Three (3) and Lot Four (4) in the Southwest Quarter (SW¼) of Section Thirty (30);

All of said land described in Group B being in Township Forty (40) North, Range Seventy-eight (78) West of the Sixth Principal Meridian, in Natrona County, Wyoming.

GROUP C

Lot Four (4) in the Northwest Quarter (NW¼) and the South Half of the Northwest Quarter (S½NW¼) of Section One (1);

Lot One (1) and Lot Two (2) in the Northeast Quarter (NE¼), and the South Half of the Northeast Quarter (S½NE¼) of Section Two (2);

163 All of said land described in Group C being in Township Thirty-nine (39) North, Range Seventy-nine (79) West of the Sixth Principal Meridian, in Natrona County, Wyoming.

Exhibit U–1

Oil and Gas Operating Lease—Examined—MSC

This Indenture of Lease, Made and entered into this 19th day of April, A. D. 1923, by and between the State of Wyoming, through its State Board of Land Commissioners, the party of the first part, and The Midwest Oil Company, a corporation duly organized under the laws of the State of Arizona, party of the second part.

1. Witnesseth: That the said party of the first part for and in consideration of the payment of an annual rental of Two Hundred Fifty Dollars ($250.00), to be applied upon a royalty hereinafter specified and agreed to, and payment of which shall be made as hereinafter provided, doth hereby lease unto the said party of the second part, its successors and assigns, the following described land, to-wit:

All of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian, containing 640 acres, more or less, in Natrona County, Wyoming.

for the purpose of drilling, boring, operating for and producing therefrom mineral oil and gas, with the right and privilege of using so much of the surface of said land as may be necessary for rights of way over said premises for pipes, pipe lines, roads, trails, flumes, ditches, and right to use and place on said premises oil and water tanks, machinery, derricks, buildings, and telephone lines necessarily used in connection with the development and operation under this lease and for all purposes connected with the business or work that may be carried on by reason of, or in pursuance of, the rights and privileges granted by this lease.

2. To Have and to Hold the said above-described premises with the appurtenances unto the said party of the second part, its successors and assigns, for the term of five years beginning on the first day of October, A. D. 1924.

164 3. The said party of the second part in consideration of the issuance of this lease on the premises aforesaid by the said party of the first part to the said party of the second part, covenants and agrees to and with the said party of the first part to pay a minimum annual rental unto the State of Wyoming, payable in advance annually at the office of the Commissioner of Public Lands of said State of the sum of Two Hundred Fifty Dollars ($250.00) to apply on a royalty hereinafter specified and agreed to.

4. The said party of the second part as a consideration for the granting of this lease agrees to pay unto the State of Wyoming at the office of the Commissioner of Public Lands as a royalty on the production of gas from said premises sixty-five per cent (65%) of all gas produced and marketed, at the field market price in the Salt Creek Field, and as royalty on the production of crude oil from said premises sixty-five per cent (65%) of all oil produced, or, at the option of

the party of the first part, the said party of the second part agrees to deliver to the said party of the first part or such individual or corporation as may be designated from time to time in writing by said first party, at the mouth of the wells on said land as a royalty on the production of oil and of gas from said premises sixty-five per cent (65%) of the gas so produced and sixty-five per cent (65%) of the oil so produced. The delivery of said royalty oil due under this lease to the said party of the first part is to be made to the Mutual Oil Company on and after October 1, 1924, up and until the 30th day of April, A. D. 1926, on and after which date the said party of the second part agrees to deliver the royalty oil to the said party of the first part or such individual or corporation as may be designated by said first party.

5. The said party of the second part agrees to drill sufficient wells to the various sands to keep the production of oil and gas on said land up to the maximum consistent with a reasonable conservation policy, which policy shall be agreed upon once a year during the life of this lease between the parties hereto, but nothing herein is to be construed into meaning that the party of the first part agrees to any other development policy than that which is hereinbefore mentioned, between the parties hereto, such agreement to be entered into by both parties hereto annually on the first of October of each year during the
165 term of this lease. The said party of the second part agrees to drill a sufficient number of wells on the premises described herein to offset producing wells, by whomsoever drilled, upon adjoining, contiguous premises, such competing wells to be drilled within such distance of competing wells upon adjoining and contiguous premises and to the same oil sands penetrated by such competitive wells as to fully accomplish the offsetting of said competitive wells; said wells shall be driven to such depth as will penetrate the oil bearing sands penetrated by wells in operation on adjoining lands.

6. Said party of the second part further covenants and agrees that it shall and will, in a good and workmanlike manner, cause to be effectually shut off any water which may enter any abandoned wells that may be drilled by it on said leased premises and will also use every effort to shut off any water which may enter producing wells drilled by it on said leased premises, and will make due and proper effort by the customary and improved methods to prevent water from infiltrating said oil territory or any part thereof.

7. The said party of the second part further agrees to make payment of the royalties hereinbefore provided to the Commissioner of Public Lands on or before the twentieth day of each month for all of the gas produced and sold during the preceding calendar month. The said party of the second part further agrees to make delivery of the royalties in kind hereinbefore provided to the Mutual Oil Company as the representatives of the party of the first part for all the oil produced and sold from time to time during the month the same is produced up and until the 30th day of April A. D. 1926, on and after which date the said party of the second part agrees to make such

delivery to the said party of the first part or such individual or corporation as may be designated by said first party.

8. The said party of the second part further covenants and agrees that all wells will be drilled, cleaned, and when necessary shot, and will be so operated as to produce at all times such production of oil as is consistent with the safety of said wells and in accordance with the provisions of Section 5 hereof. Provided, however, that if fire or other unavoidable casualty shall destroy the refinery or storage tanks used in connection with handling the oil and gas produced from the land described, or if for any other good and sufficient reason the
166 said party of the second part shall not be able to deliver said oil or gas from said land, then and in that event the said party of the second part shall have the right to apply to the said party of the first part for a reduction of the production of oil and gas from the land described herein to such an extent and for such period of time as the conditions may warrant.

9. Said party of the second part further covenants and agrees that no casing shall be removed from any of the wells heretofore drilled or which may hereafter be drilled on the land described except with the approval and consent of the said party of the first part and that upon the abandonment of cessation of use of any well on the said described land, the said party of the second part will securely plug such well in conformity with the provisions of the laws of the State of Wyoming and will notify the Commissioner of Public Lands in writing of such abandonment, cessation of use, and plugging of well and the date thereof. Should the said party of the second part decide that it would be to the mutual benefit of both parties to this lease to deepen any exising well or any well that may hereafter be drilled on this lease to the present producing sand to what is known as the lower sand or sands, as the case may be, the contemplated deepening of said well or wells shall not be undertaken without the consent of the said party of the first part.

10. The said party of the second part further covenants and agrees that in the drilling and operation of wells on the land described, it will exercise the greatest care and diligence to prevent the flow of water into the oil-producing sands, to prevent the escape of gas and to protect and conserve the oil and gas from waste and destruction.

11. The said party of the second part further covenants and agrees to keep all of the oil and gas produced from the land described herein under the terms of this lease entirely separate and apart from any other oil or gas until the same has been gauged or measured; that it will accurately measure all the oil and gas produced under the terms of this lease and keep a record of such production separate and distinct from the record of production of oil and gas from other lands; and it is understood and agreed by and between the parties hereto that the said party of the first part, through its Commissioner of Public Lands, or its duly authorized agent or agents, shall have the right to measure such oil and gas or observe the measurements
167 made by the said party of the second part, and shall have the

right to examine the books and records of said party of the second part pertaining to the production of oil and gas from the land described in this lease, and shall at all times during the term of this lease have a right to go upon the said premises and into every part thereof for the purpose of inspecting the same and of examining the books or accounts and records of workings and production thereon and of ascertaining whether or not the said party of the second part, or any person or corporation holding or operating under, by or from it, is carrying out the terms, covenants, and agreements in this lease contained, and the said party of the second part agrees to render to the agent or agents of the said party of the first part as aforesaid every assistance under the provisions of this clause.

12. The said party of the second part further covenants and agrees that on or before the twentieth day of each month it will send to the Commissioner of Public Lands, accompanied by the remittance of the royalty on gas as provided herein, a written statement verified under oath by its duly authorized officer or agent, showing the total production in barrels of oil, and cubic feet of gas, and any other production, under the terms of this lease for the preceeding calendar month, itemizing the production from the different wells as nearly as possible and attaching to said sworn return a copy of the schedule or schedules of runs of oil.

13. The said party of the second part shall keep a correct log of each well drilled under the terms of this lease, showing the important formations passed through, the depth at which each formation was reached, the thickness of each formation, the water bearing formations, and the character of the water therein, the elevation to which the water rises, the number of feet of casing set in such well and where placed, its size and the total depth to which such well was drilled, and shall file a progress report on such well in the office of the Commissioner of Public Lands at the end of each period of sixty days while any such well is being drilled, and shall, within thirty days after the completion or abandonment of each well, file a copy of the entire log of such well, sworn to by the person who made such log, in the office of the Commissioner of Public Lands.

14. The said party of the second part further agrees that it
168 shall and will fully pay, when they fall due, all bills for machinery, lumber, timber, and other materials, all wages for labor, and all other demands caused by its operations hereunder on said demised lands, so that no laborers' or mechanics' liens, attachments, or liens of any character shall arise against said demised land, and said party of the second part covenants and agrees that no mechanics' liens or other liens shall ever attach thereto, and said party of the second part further covenants and agrees to bear, pay, and discharge in addition to the said royalties to be paid said party of the first part on said leased and demised land, all state and county taxes which may be lawfully taxed, levied, or imposed upon the personal property on said premises.

15. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that if the payments hereinbefore provided for or any part thereof shall be behind or unpaid on the date whereon the same should be paid as aforesaid, or if default shall be made in any of the covenants or agreements herein contained to be kept and performed by the said party of the second part, its successors or assigns, the said party of the first part, through its Commissioners of Public Lands, shall serve notice in writing on the said party of the second part, either by personal service or by registered mail of such default, and if the said party of the second part shall fail to perform the covenants and agreements of this lease so defaulted in within thirty days from the date said notice is served personally, or from the date said notice is mailed by registered mail, then the said party of the first part may declare the term of this lease ended and terminated and may cancel the same and re-enter into the said premises or any part thereof; and in case of default in and of any of the covenants or agreements herein contained by the said party of the second part upon thirty days notice by the said party of the first part to the said party of the second part that the term of this lease has been declared ended and the lease terminated and canceled as aforesaid, the said party of the second part hereby agrees to surrender the peaceful and uninterrupted possession of the said premises to the said party of the first part; and that neither the said party of the second part nor its legal representatives, nor assigns, will permit any loss, or permit or cause to be permitted any waste or destruction in, to or upon said premises
169 or any part thereof, or the minerals therein, nor remove any improvements placed thereon without the consent of the said party of the first part.

16. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that no assignment of this lease shall be made by the said party of the second part except with the consent and approval of the said party of the first part.

17. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that this lease is to be construed under the provisions of the laws of the State of ject to the granting of rights of way under the provisions of Sections 745 and 4954 of the Wyoming Compiled Statutes of 1920, but all rights of way granted shall be upon condition that the use thereof or structures to be erected thereon shall be of such a character as not to interfere with the operations and improvements of the said party of the second part which are being made, carried on, or in existence, under the terms of this lease at the time of the granting of such rights of way.

18. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that this lease is to be construed under the provisions of the laws of the State of

Wyoming; and in case at the expiration of this lease by limitation, forfeiture, or otherwise, the said land is leased to another party than the said party of the second part, the lessee herein, then and in that event the improvements placed on said land under the terms of this lease will be controlled as provided in Section 718 of the Compiled Statutes of Wyoming of 1920.

19. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that all oil or gas, or other minerals or by-products thereof extracted, produced, or removed under the provisions of this lease during the term thereof, and from the land described herein, shall be refined, manufactured, reduced, or otherwise treated preparatory to furnishing for market and sale wholly and entirely within the State of Wyoming, and that no refining manufacturing, reduction, or other treatment of such minerals or by-products shall be done or performed outside of the State of Wyoming.

170 20. Said party of the second part, as a consideration for the granting of this lease and to secure to the said party of the first part full compliance with all of the covenants, terms, and conditions thereof, hereby agrees to furnish and furnishes coordinate with the execution of this lease and as a part thereof, a bond as required by Section 720, Wyoming Compiled Statutes of 1920, in the penal sum of Seventy-five Thousand Dollars ($75,000) by a responsible bonding company authorized to transact business in the State of Wyoming, the said bond shall be approved by the said party of the first part.

In Witness Whereof, The said party of the first part has caused these presents to be signed by its President and countersigned by its Secretary, and its seal affixed, and the said party of the second part has caused this instrument to be executed by its duly authorized officers, and its seal affixed.

[SEAL] (Signed) WILLIAM B. ROSS,
President, State Board of Land Commissioners.

Countersigned:

(Signed) C. N. MCWHINNE,
Commissioner of Public Lands.

THE MIDWEST OIL COMPANY,

[SEAL] (Signed) By A. D. AITKEN, *Vice-President,*

Signed by Vice-President in presence of
(Signed) HAROLD D. ROBERTS.

Attest:

(Signed) H. H. BROOKS, *Secretary.*

Signed by Secretary in presence of
(Signed) HAROLD D. ROBERTS.

Recording Fee $10.00 entered May 17, 1923. Receipt No. —.

Exhibit U–2

OIL AND GAS LEASE

This Indenture of Lease, made and entered into this 1st day of October, A. D. 1919, by and between The State of Wyoming, through its State Board of School Land Commissioners, party of the first part, and Midwest Oil Company, a corporation organized and existing under and by virtue of the laws of the State of Arizona, party of the second part, Witnesseth:

171 1. That the said party of the first part, for and in consideration of the royalty hereinafter specified and agreed to, the payment of which shall be made as hereinafter provided, does hereby lease unto the said party of the second part, its successors and assigns, the following described land, to-wit: All of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West of the Sixth Principal Meridian, containing 640 acres, more or less, in Natrona County, Wyoming, for the purpose of drilling, boring, operating for and producing therefrom mineral oil and gas, with the right and privilege of using so much of the surface of said land as may be necessary for rights of way over said premises for pipes, pipelines, roads, trails, flumes, ditches, and right to use and place on said premises oil and water tanks, machinery, derricks, buildings, and telephone lines necessarily used in connection with the development and operation under this lease and for all purposes connected with the business or work that may be carried on by reason of, or in pursuance of the rights and privileges granted by this lease.

2. To Have and to Hold the said above-described premises with the appurtenances, unto the said party of the second part, its successors and assigns, for the term of five (5) years from the first day of October, A. D. 1919.

3. The said party of the second part, as a consideration for the granting of this lease, agrees to pay unto the State of Wyoming, at the office of the Commissioner of Public Lands as a royalty on the oil and gas produced and saved from said described land thirty-three and one-third (33⅓%) per cent of the market value at the mouth of the wells thereon of the crude oil, the minimum value to be not less than One Dollar and Fifty Cents ($1.50) per barrel and thirty-three and one-third (33⅓%) per cent of the market value of the wet gas produced and used or sold, the minimum value to be not less than Seven Cents ($.07) per thousand cubic feet, or at the option of the said party of the first part the said party of the second part agrees to deliver to the said party of the first part or such individual or corporation as may be designated in writing by said party of the first part, at the mouth of the wells on said land, as a royalty on the production of oil and gas from said land thirty-three and one-third (33⅓%) per cent of the oil and gas produced therefrom.

172 As a further consideration for the granting of this lease, the said party of the second part agrees to secure and maintain the maximum production of oil and gas from the land embraced herein and to operate the wells drilled and to be drilled under the provisions of this lease to their fullest capacity at all times during the term of this lease.

The party of the second part warrants and guarantees that the income of the State of Wyoming from the sale of the royalty oil and gas reserved hereunder, providing the same is sold at not less than the field market price, shall be not less than Fifteen Thousand ($15,000.00) Dollars per month during the first year of the term of this lease and not less than Twenty-five Thousand ($25,000.00) Dollars per month during the balance of said term, and does covenant and agree that if the income of the State from such source shall in any month be less than the amount above specified, it will within ten days after notice thereof from the Commissioner of Public Lands, pay to him an amount sufficient to make up such deficit.

4. As a further consideration for the granting of this lease the said party of the second part agrees to commence within thirty days from the date hereof the drilling of two wells to the oil-bearing sand locally known as the Second Wall Creek Sand, and thereafter to prosecute the said work diligently and continuously until the said wells shall be completed, and thereafter to keep two drilling rigs continuously at work upon said land, drilling additional wells to the Second Wall Creek Sand until the average daily production of oil from said land for a continuous period of one month shall equal or exceed thirty-five hundred barrels; and the party of the second part further covenants and agrees that in each year of the term of this lease after said production has been attained it will drill upon said land a sufficient number of wells to the Second Wall Creek Sand to maintain an average daily production from said land of thirty-five hundred barrels; provided, that the party of the second part shall not in any year after the first year of the term of this lease, be required to drill more than five wells to said sand; and the party of the second part further agrees to drill on the premises described herein additional wells of a sufficient number to offset producing wells, by whomsoever drilled, upon adjoining, contiguous premises, such competing wells to be drilled within such a distance of competing wells upon adjoining and contiguous
173 premises and to the same oil sands penetrated by such competitive wells as to fully accomplish the offsetting of said competitive wells; all wells shall be driven to such a depth as will penetrate the oil bearing sands penetrated by wells in operation on adjoining lands, and all wells shall be so drilled, cleaned, and if necessary, shot, and shall be so operated as to produce the greatest production of oil possible, consistent with the safety of said wells; provided, however, that if fire, or other unavoidable casualty shall destroy the refinery or storage tanks used in connection with the handling of the products from the land described, or if for any other reason the lessee shall not

be able to market the oil from said land, then, upon a proper and satisfactory showing to the State Board of School Land Commissioners by the party of the second part of its inability to handle and care for the product from the land herein described, the State Board of School Land Commissioners may authorize the reduction of the production of oil from the land described herein, to such extent and for such time as the facts and conditions shall warrant. In the drilling of the additional wells to the Second Wall Creek Sand provided for herein, and to secure the fullest drainage and production of oil from said sand, the said party of the second part further agrees to drill two out of each three of said wells along the entire outer or exterior boundaries of the land embraced herein before drilling any wells in the exterior of said land.

5. The said party of the second part shall keep a correct log of each well drilled under the terms of this lease, showing the important formations passed through, the depths at which each formation was reached, the thickness of each formation, the water-bearing formations and the character of the water therein, the elevation to which the water rises, the number of feet of casing set in such well and where placed, its size, and the total depth to which such well was drilled and shall, within thirty days after the completion of each well, file a copy of said log, sworn to by the person who made the log, in the office of the Commissioner of Public Lands.

6. It is further agreed by the said party of the second part that no casing shall be removed from any of the wells heretofore drilled, or which may be hereafter drilled on the land described, without the consent of the party of the first part; and that upon the abandonment or the cessation of use of any well on the said described
174 lands, said party of the second part shall securely plug such well, in conformance with the provisions of the laws of the State of Wyoming, and shall notify the Commissioner of Public Lands in writing of the date of such abandonment or cessation of use and plugging of well within thirty days from date thereof.

7. It it specifically agreed by the party of the second part that in the drilling and operation of wells on the land described, it will exercise the greatest care and diligence to prevent the flow of water into the oil sands, to prevent the escape of gas, and to protect and conserve the oil from waste.

8. The said party of the second part agrees to keep the oil produced from the said land described herein entirely separate from any other oil until the same has been gauged or measured, that it will accurately measure the oil produced under the term of this lease and keep a record of such production separate and distinct from the records of production of oil from other lands; and it is understood and agreed by and between the parties hereto that the party of the first part, through its Commissioner of Public Lands, or any other duly authorized agent, or agents, shall have the right to measure such oil or observe the measurements made by the party of the second part, and

shall have the right to examine the books and records of said party of the second part pertaining to the production of oil from the land described in this lease, and shall at all times during the term of this lease have a right to go upon the said premises and into every part thereof for the purpose of inspecting the same and of examining the books of accounts and records of workings thereon; and of ascertaining whether or not the lessee, or any party holding thereunder, by or from said lessee, is carrying out the terms, covenants, and agreements in this lease contained; and the party of the second part agrees to render to the agent of the party of the first part every assistance in his operations under the provisions of this clause.

9. The said party of the second part agrees that on or before the twentieth day of each calendar month, it will send to the Commissioner of Public Lands for the State of Wyoming, with the remittance of the royalty herein provided for, a statement verified under oath by one of its responsible officers showing the daily production in barrels of oil and the total production for the month, and the daily production in cubic feet of gas and the total production for the
175 month, under the terms of this lease, for the preceding month and attach to said production statement copies of the schedules of runs of oil.

10. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that this lease is to be construed under the provisions of the laws of the State of Wyoming; and in case at the expiration of this lease by limitation, forfeiture, or otherwise, the said lands are leased to another party than the said party of the second part, the lessee herein, then and in that event the improvements placed on said land under the terms of this lease will be controlled as provided in Section 622 of the Compiled Statutes of Wyoming of 1910, as amended and re-enacted by Chapter 80 of the Session Laws of 1915.

11. It is expressly understood and agreed by and between the parties hereto, that if the payments hereinbefore provided for, or any part thereof, shall be behind or unpaid on the day whereon the same should be paid as aforesaid, or if default shall be made in any of the covenants or agreements herein contained to be kept and performed by the said party of the second part, its successors or assigns, the said party of the first part shall serve notice on the party of the second part, either by personal service or by registered letter, of such default; and if the party of the second part shall fail to perform the covenants of this lease defaulted in within 30 days from the date said notice is served, or from the date said notice is mailed, then the said party of the first part may declare the term of this lease ended and terminated and cancel the same and re-enter into the said premises, or any part thereof; in case of default in and of any of the covenants herein contained, by the party of the second part, upon thirty days' notice by the party of the first part to the party of the

second part that the term of this lease has been declared ended and the lease terminated and cancelled, the said party of the second part agrees to surrender the peaceful possession of the premises to the party of the first part; and that neither the party of the second part nor its legal representatives or assigns, will permit any loss, or permit or cause to be permitted any waste or destruction in, to, or upon said premises or any part thereof, or remove any improvements placed thereon, without the consent of the party of the first part.

176 12. It is understood and agreed by and between the parties hereto that no assignment of this lease shall be made by the party of the second part except with the consent and approval of the party of the first part.

13. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that this lease is made subject to all legally established rights of way and subject to the granting of rights of way under the provisions of Sections 649 and 3890 of the Wyoming Compiled Statutes of 1910, but all rights of way granted shall be upon condition that the use thereof or structures erected thereon shall be of such character as not to interfere with the operations and improvements of said party of the second part which are being had, carried on, or in existence under the terms of this lease at the time of the granting of such rights of way.

14. It is further mutually agreed that the execution of this lease by the party of the second part shall constitute a surrender of the lease upon said land from the State of Wyoming to the party of the second part dated December 31, 1914, which surrender is hereby accepted by the party of the first part; provided, that with respect to all production from said land and operations thereon prior to October 1, 1919, the parties shall be bound by the covenants and provisions of said lease, and all rights accruing thereunder to the State of Wyoming may be enforced.

15. It is expressly understood and agreed by and between the said party of the first part and the said party of the second part that all oil or gas or other minerals or by-products thereof extracted, produced, or removed under the provisions of this lease during the term thereof and from the land described therein, shall be refined, manufactured, reduced, or otherwise treated preparatory to furnishing for market and sale, wholly and entirely within the State of Wyoming, and that no refining, manufacturing, reducing, or other treatment of such minerals or by-products shall be done or performed outside of the State of Wyoming.

In Witness Whereof, said party of the first part has caused these presents to be signed by its President and countersigned by the Commissioner of Public Lands, and its seal to be hereunto affixed,

177 and the said party of the second part has caused its corporate name to be hereunto subscribed by its President and attested

and its corporate seal affixed by its Secretary, the day and year first above written.

[SEAL] (Signed) ROBERT D. CAREY,
President State Board of School Land Commissioners.

Countersigned:
(Signed) A. BAKER,
Commissioner of Public Lands.

MIDWEST OIL COMPANY,
[SEAL] (Signed) By L. L. AITKEN, *President.*

Signed by Lessee in the present of E. Morrison.
(Signed) J. L. WARREN, *Secretary.*

Exhibit U–3

OIL OR MINERAL LEASE

This Indenture of Lease, Made and entered into this 26 day of December, A. D. 1914, by and between the State of Wyoming, through its State Board of School Land Commissioners, party of the first part, and the Midwest Oil Company, of the County of Denver, State of Colorado, a corporation organized under the laws of the State of Arizona and authorized to do business in the State of Wyoming, party of the second part,

(1) Witnesseth: That the said party of the first part for and in consideration of a monthly rental of Three Thousand Dollars ($3,000.00), to be applied upon a royalty hereinafter specified and agreed to and payment of which shall be made as hereinafter provided, does hereby lease unto the said party of the second part, its successors and assigns, all of Section Thirty-six (36), Township Forty (40) North, Range Seventy-nine (79) West, for the purpose of drilling, boring, operating for, developing and removing therefrom mineral oil, including all rights of prospecting for, developing and producing oil from said lands, with the right and privilege of using so much of the surface of said land as may be necessary for rights of way over
178 said premises for pipes, pipelines, roads, trails, flumes, ditches, and rights to use and place on said premises oil and water tanks, machinery, derricks, buildings, and telephone lines necessarily used in connection with the development and operations under this lease and for all purposes connected with the business or work that may be carried on by reason of or in pursuance of the rights and privileges granted by this lease.

(2) To Have and to Hold the said above-described premises with the appurtenances unto the said party of the second part, its successors and assigns, for the term of five (5) years from the beginning of the day of the 1st day of January A. D. 1915.

(3) The said party of the second part, in consideration of the issuance of this lease on the premises aforesaid by the said party of the first part to said party of the second part, does covenant and agree to

and with the said party of the first part to pay a minimum monthly rental unto the State of Wyoming, at the office of the Commissioner of Public Lands of said State, of the sum of Three Thousand Dollars ($3,000.00) to apply upon a royalty hereinafter specified and agreed to.

(4) The said party of the second part further agrees, in consideration of the granting of this lease, to pay unto the State of Wyoming, at the office of the Commissioner of Public Lands, as royalty on the production of oil from said described land, the sum of twelve and one-half cents (12½c) per barrel, of forty-two (42) gallons each, for all oil produced from said land, under the terms of this lease (less three per cent (3%) shrinkage for water and other foreign substances), which price and method of payment has been agreed upon between the parties hereto for convenience of operation under the conditions hereof and purchase of royalty oil as the equivalent of that royalty or proportion of the gross output of the mineral oil from the premises described herein which the laws of the State provide may be received by the State therefrom. If said royalty shall exceed in any month of the term of this lease the minimum monthly rental of Three Thousand Dollars ($3,000.00), then said minimum monthly rental of Three Thousand Dollars ($3,000.00) so paid for such month shall be applied upon the amount of royalty charged for that month; if the production be less than twenty-four thousand (24,000) barrels in any month, the royalty thereon shall apply upon the minimum payment of Three
179 Thousand Dollars ($3,000.00) for such month; payment of such monthly rental and royalty to be made on or before the 20th day of each month, for the oil produced during the preceding month.

(5) As a further consideration for the granting of this lease, the said party of the second part agrees to drill, upon the premises described herein, six (6) standard oil wells during each year of the first three (3) years of the running of this lease; the location of said wells to be agreed upon between the party of the second part and the Commissioner of Public Lands of Wyoming, and on that part or parts of said premises as have been, or shall be hereafter shown to best produce mineral oil; the first well to be started as soon after January 1st, 1915, as weather and water conditions will permit, and to be completed as soon as weather and water conditions will permit, and thereafter, one well at least shall be completed every sixty (60) days, provided weather and water conditions will permit, but however, a total of at least six (6) wells shall be drilled during each year of the first three (3) years of this lease; said wells shall be driven to such depth as will penetrate the oil-bearing sands now penetrated by other wells in operation on the land described herein, and such new wells shall be so drilled and, if necessary, shot, and such new wells and also the wells now in operation on said described land shall be so operated as to produce the greatest production of oil possible consistent with safety of said wells. Provided, however, that if fire or other unavoidable casualty shall destroy the refinery or storage tanks used in connection with the handling of the products from the land described, then, upon a proper and satisfactory showing to the State

Board of School Land Commissioners, by the party of the second part, of its inability to handle and care for the product from the land herein described, the State Board of School Land Commissioners shall authorize the reduction of the production of oil from the land described herein, to such an extent and for such a time as the facts and conditions shall warrant.

(6) Said party of the second part further agrees to drill a sufficient number of wells, on the premises described herein, to off-
180 set producing wells by whomsoever drilled upon adjoining, contiguous premises, such competing wells to be drilled within such a distance of competitive wells on adjoining and contiguous premises, and to the same oil sands penetrated by such competitive wells, as to fully accomplish the offsetting of said competitive wells, such wells to be part of the eighteen (18) wells required to be drilled as hereinabove provided.

(7) The said party of the second part shall keep a correct log of each well drilled under the terms of this lease, showing the important formations passed through, the depth at which each formation was reached, the thickness of each formation, the water bearing formations and the character of the water therein, the elevation to which the water rises, the number of feet of casing set in such well and where placed, its size and the total depth to which such well was drilled, and shall, within thirty (30) days after the completion of each well, file a copy of said log certified to by the person who made the log, in the office of the Commissioner of Public Lands.

(8) It is further agreed by the said party of the second part that no casing shall be removed from any of the wells heretofore drilled or which may be hereafter drilled on the land described, without the consent of the party of the first part; and that upon the abandonment or the cessation of the use of any well on the said described lands, said party of the second part shall securely plug such well, in conformance with the provisions of Chapter 46 of the Session Laws Wyoming 1913 and amendments which may be made thereto.

(9) It is specifically agreed by the party of the second part that in the drilling and operation of wells on the land described that it will exercise the greatest care and diligence to prevent the flow of water into the oil sands, to prevent the escape of gas, and to protect and conserve the oil from waste.

(10) It is further agreed by the party of the second part that if the production of oil from the land herein described shall fall below twenty-four thousand (24,000) barrels per month, that it will, at the request of the party of the first part, sink a well to test and prospect the oil sands below the sand from which the oil is now obtained.

(11) The said party of the second part agrees to keep the oil
181 produced from the land described herein entirely separate from any other oil until the same has been gauged or measured; that it will accurately measure the oil produced under the terms of this

lease and keep a record of such production separate and distinct from the records of production of oil from other lands; and it is understood and agreed by and between the parties hereto, that the party of the first part, through its Commissioner of Public Lands or any other duly authorized agent or agents, shall have the right to measure such oil or observe the measurements made by the party of the second part, and shall have the right to examine the books and records of said party of the second part pertaining to the production of oil from the land described in this lease, and shall at all times during the term of this lease have a right to go upon the said premises and into every part thereof for the purpose of inspecting the same and of examining the books of accounts and records of workings thereon, and of ascertaining whether or not the lessee or any party holding thereunder, by or from said lessee, is carrying out the terms, covenants, and agreements in this lease contained; and the party of the second part agrees to render to the agent of the party of the first part every assistance in his operations under the provisions of this clause.

(12) The party of the second part agrees that on or before the 20th day of each month, it will send to the Commissioner of Public Lands, with the remittance of the rental and royalty, a verified statement of the production of oil under the terms of this lease, for the preceding month, itemizing the production from the different wells as nearly as possible.

(13) It is hereby stipulated and agreed by and between the parties hereto, that at the expiration of this lease, in the event that the lands herein described shall be leased to a person or company other than the lessee herein, that such new lessee shall pay to the lessee herein the value of the improvements placed on said land, owned by the said lessee herein; the value of said improvements to be determined by agreement between the new lessee and the lessee herein, or if they cannot agree, then by appraisement under the direction of the State Board of School Land Commissioners. The word "improvements" is herein defined as being property placed on and in the land described herein, such as casing pipes, pipelines, pumps, pumping ma-
182 chinery, tanks, including measuring devices installed therein or attached thereto, derricks, boilers, powerhouses, power plants, engines, and machinery, and all other necessary appliances used in the development and operation of the lands leased hereunder, but shall not include the oil wells heretofore drilled on the land described herein or which may be hereafter drilled on said land under the provisions thereof; nothing in the definition of the word "improvements" as herein contained shall be construed as embracing pipelines which form a general part of the piping system of the party of the second part and pipelines which are not purely local to the ground leased. In the event that at the expiration of this lease the party of the first part shall not lease said property to the party of the second part, or to any one else, but shall retain the same, or in the event that

at the expiration of this lease the State shall sell said property to a person or company other than the lessee hereunder, then disposition of the improvement shall be made in like manner as hereinbefore in this paragraph provided for.

(14) It is expressly understood and agreed by and between the parties hereto, that if the payments hereinbefore provided for or any part thereof shall be behind or unpaid on the day whereon the same should be paid as aforesaid, or if default shall be made in any of the covenants or agreements herein contained to be kept and performed by the said party of the second part, its successors or assigns, or if this lease shall have been procured by fraud, deceit, or misrepresentation, the said party of the first part may declare the term of this lease ended and terminated and cancel the same and re-enter into the said premises or any part thereof. In case of default in and of any of the covenants herein contained, by the party of the second part, upon thirty (30) days' notice by the party of the first part to the party of the second part that the term of this lease has been declared ended and the lease terminated and canceled, the said party of the second part agrees to surrender the peaceful possession of the premises to the party of the first part.

(15) It is understood and agreed by and between the parties hereto that no assignment of this lease shall be made by the party of the second part except with the consent and approval of the party of the first part; and the party of the second part does further covenant and agree that at the expiration of the term of this lease, or its
183 cancelation or termination by default, as above provided, that the said party of the second part will yield up said premises unto the said party of the first part, and that neither the party of the second part or its legal representatives or its successors or assigns will permit any loss, or permit or cause to be permitted any waste, in, to, or upon said premises or any part thereof, or remove any improvements placed thereon, without the consent of the party of the first part.

(16) It is further understood and agreed that this lease is made subject to all legally established rights of way and subject to the granting of rights of way under the provisions of Chapter 85, Session Laws of 1905; but all rights of way granted shall be upon the condition that the use made thereof or structures to be erected thereon, shall be of such character as not to interfere with the operations and improvements of the party of the second part which are being had or are in existence at the time of the granting of such rights of way.

(17) It is hereby stipulated and agreed by and between the parties hereto, that should any laws of the State of Wyoming governing conditions in this lease contained, be changed or amended during the term of this lease, that this lease shall be subject to and construed under the terms and provisions of the law or laws as thus changed or amended; provided, however, that nothing in this clause shall be

construed as authorizing any increase of the present requirements or payments upon the party of the second part agreed to hereunder or diminish the term hereof.

(18) As for further consideration for the granting of this lease, the party of the second part hereby agrees to surrender to the State of Wyoming its lease to the lands herein described, dated January 4th, 1910, issued to William M. Fitzhugh and assigned by William M. Fitzhugh to the Midwest Oil Company, party of the second part; and it is hereby stipulated and agreed by the parties hereto that said lease and all the rights of the party of the second part thereunder shall cease and terminate at midnight of the night of December 31st, 1914.

In Witness Whereof, said party of the first part has caused these presents to be signed by its President and countersigned by the
184 Commissioner of Public Lands, and its seal to be hereunto affixed; and the said party of the second part has hereunto caused this instrument to be executed in its name, and on its behalf, and under its corporate seal, by its President and Secretary.

Done in the City of Cheyenne, State of Wyoming, this 26 day of December, A. D. 1914.

[SEAL] (Signed) JOSEPH M. CAREY,
President, State Board of School Land Commissioners.

Countersigned:

(Signed) S. G. HOPKINS, *Commissioner of Public Lands.*

THE MIDWEST OIL COMPANY,

[:5(-] (Signed) By J. L. WARREN, *President.*

Attest:

(Signed) A. L. HESS, *Secretary.*

Signed, sealed, and delivered by the Lessee, in the presence of:

(Signed) L. A. MILLER.

Exhibit U–4

OIL OR MINERAL LEASE

This Indenture, made and entered into this 4th day of January, A. D. 1910, by and between the State of Wyoming, through its State Board of School Land Commissioners, party of the first part, and Wm. M. Fitzhugh, of the County of Natrona, State of Wyoming, party of the second part.

Whereas, said party of the second part has made application for a mineral lease under the provision of Chapter 81, Session Laws of Wyoming, 1907, on Section 36, Township 40 North, Range 79 West, by bidding at public auction for a lease on said land.

Now, Therefore, This Indenture Witnesseth, that the said party of the first part, for and in consideration of the application aforesaid,

the representations therein made and the covenants and agreements hereinafter mentioned, to be kept and p'rformed by the said party of the second part, his legal representatives or assigns has demised and leased to the said party of the second part, the lands hereinbefore described for the purpose of prospecting for and producing oil.

185 To Have and to Hold the said above-described premises, with the appurtenances, unto the said party of the second part, his executors, legal representatives or assigns, for the term of five years from the 4th day of January, A. D. 1910.

And the said party of the second part, in consideration of the issuance of this oil lease on the premises aforesaid by the said party of the first part to the said party of the second part, does covenant and agree to and with the said party of the first part to pay annually unto the State of Wyoming, at the office of the Commissioners of Public Lands, the sum of Five Hundred Dollars to apply on a royalty of ten per cent of the gross amount of oil porduced from said section during the year for which payment is made.

It is expressly understood and agreed that the party of the second part shall, during each year of the term of this lease, expend in development work not less than one hundred dollars, and shall during the first six months of this lease, expend in development work, buildings or machinery not less than Five Thousand Dollars. Said party of the second part hereby agrees to submit sworn statements of any minerals extracted at the end of each and every three months from the first day of January 1910, accompanied with a remittance for any royalty due upon same, and to open his books to the inspection of an agent of the State for the purpose of verifying said statements if deemed necessary by said party of the first part; and it is further understood that if the said party of the second part, his successors or assigns, shall, during the term of this lease, construct suitable surface improvements, and install machinery and equipment sufficient for the purpose of carrying on the business of producing oil the said party of the second part shall have a preference right to renew said lease for further terms of five years each upon such terms as may be prescribed by the State Board of School Land Commissioners; and provided that the said lessee shall file with the Commissioner of Public Lands, on or before the first day of February of each year a sworn statement covering the year expiring December 31st, prior thereto, corroborated by two witnesses, showing that he has performed the required amount of work upon said land, and the party of the second part, for and in consideration of the execution of this lease, hereby agrees to make and render full, true, and correct statements of all oil produced

186 from said section during the periods herein described under the terms of this lease, and to file such statements in the office of the Commissioner of Public Lands on or before the first day of February of each year, covering the year expiring December 31st,

prior thereto, and further agree that such statements shall be subject to verification by examination of the books of said lessee.

It is expressly understood and agreed by and between the parties aforesaid that no assignment of this lease shall be made by the party of the second part except with the consent and approval of the party of the first part. And the said party of the second part does further covenant and agree to and with the said party of the first part that said second party at the expiration of the term, or the cancellation of this lease, will yield up said premises unto the said party of the first part, and that neither he, the said Wm. M. Fitzhugh, nor his legal representatives or assigns, will permit any loss, or commit or cause to be committed any waste in, to or upon said premises, or any part thereof.

It is expressly understood that this lease is made subject to all legally established rights of way and subject to the grant of rights of way under the provisions of Chapter 85, Session Laws 1905.

And it is expressly understood and agreed by and between the parties aforesaid that if the payments, hereinbefore reserved, or any part thereof, shall be behind and unpaid on the day whereon the same ought to be paid as aforesaid, or if default shall be made in any of the covenants or agreements herein contained to be kept by the said party of the second part, his successors, administrators, or assigns, or if this lease shall have been procured by fraud, deceit, or misrepresentation, it shall and may be lawful for the said party of the first part to declare such term ended, cancel this lease, and into the said premises, or any part thereof, to re-enter.

In case of default in and of any of the covenants herein contained, upon thirty days' notice by the party of the first part to the party of the second part that the term has been declared ended, the said party of the second part agrees to surrender the peaceful possession of the premises to the party of the first part.

187 SPECIAL PROVISIONS

It is expressly understood and agreed by and between the State Board of School Land Commissioners and William M. Fitzhugh, that this lease is subject to cancellation at the option of the said Board, unless active drilling operations shall be begun on the land covered by this lease by the said William M. Fitzhugh, or his assigns, on or before April 1st, 1910, and continued without cessation until oil is developed to the satisfaction of the lessee and in quantities sufficient for commercial production, it being understood and agreed that at least $5,000.00 shall be expended in the installation of machinery and the construction of buildings and drilling operations upon the land prior to August 1st, 1910, it being mutually agreed that this lease may be surrendered and cancelled at the request of the lessee after

the first year, if continuous drilling does not develop oil sufficient for commercial production. It is further understood and agreed that if the conditions of this lease are fully carried out and complied with by the said lessee, that the said lessee or his approved assigns shall be entitled to a preference right to renew this lease under such terms as may be fixed by the Board, requiring the production of at least 30,000 barrels of oil per annum, or an amount to be mutually agreed upon which shall not be less than the proportionate amount produced and marketed from adjoining lands under lease in the same proportion as the area of the land heretofore described shall bear to the area of other tracts of contiguous land actively producing oil. It is further understood and agreed that the party of the second part shall at the option of the party of the first part purchase all the oil accruing to the party of the first part through its royalty of 10% of the gross amount produced at the price of not less than 50c per barrel. It is further understood and agreed that in lieu of the production and purchase of the oil accruing to the party of the first part, the party of the first part may require a large annual payment of advanced royalty and may fix a time for the termination of the lease by reason of the failure of the party of the second part to market the amount of oil, which, in the opinion of the said Board, should be produced from the land covered by this lease.

The annual payments of advance royalty shall be made at the times as follows, to-wit:

188 Less filling and recording fees $17.00	Month Day Year	Amount	By whom received for State Board of School Land Commissioners	Date
First Payment	January 4, 1910	$483	R. P. Fuller, per L. G.	Feb. 24, 1910
Second Payment	January 4, 1911	$500	R. P. Fuller, per L. E.	Dec. 30, 1910
Third Payment	January 4, 1912	$500	S. G. Hopkins (E. F.)	Dec. 30, 1911
Fourth Payment	January 4, 1913	$500	S. G. Hopkins, J. H.	Jan. 14, 1913
Fifth Payment	January 4, 1914	$500	S. G. Hopkins, E. F.	Jan. 19, 1914

In Witness Whereof said party of the first part hath caused these presents to be signed in duplicate by its President and countersigned by the Commissioner of Public Lands, and its seal to be hereunto affixed; and the party of the second part has hereunto set his hand and seal the day and year first above written.

BRYANT B. BROOKS,
President, State Board of School Land Commissioners.

[Seal of State Board of School Land Comm's, Wyo.]

Countersigned:

R. P. FULLER,
Commissioner of Public Lands.

Signed by Lessee in Presence of
JESSE E. WHALED.

WM. M. FITZHUGH.

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Exhibit V

AGREEMENT OF 2/1/23 WITH M. R. CO.

		Production (barrels)	Income rec'd at contract price by W. A. Oil Corp.	General and overhead expense of W. A. Oil Corp.	Net income of W. A. Oil Corp.	Field operating expense of Midwest Ref'g Co.
Group A:						
S½ SE and NW SE	14-40-79	135,796.12	135,539.63	4,161.22	131,378.41	81,194.78
SW	14	98,781.70	95,125.37	2,789.65	92,335.72	59,067.58
S½ NW and NW NW	14	118,250.94	114,497.97	3,439.89	110,998.08	70,709.43
NE	15	102,323.24	98,702.26	3,186.43	95,515.83	61,185.29
E½ NE SE	15	14,339.16	13,353.35	389.98	12,963.37	8,574.26
S½ SE	22	68,506.49	63,782.83	2,062.41	61,720.42	40,964.20
E½ NE	23	91,169.59	88,721.48	2,667.59	86,053.89	54,515.84
NE SE and SW SE	23	136,632.77	134,617.06	3,768.79	130,848.27	81,701.04
SE SW	23	37,503.14	36,621.43	1,347.63	35,273.80	22,425.41
SW SW	23	7,985.73	7,384.51	234.16	7,150.35	4,775.15
NE	24	265,292.75	252,879.64	9,285.07	243,594.57	158,634.67
N½ SE	24	205,316.57	206,301.56	6,009.98	200,291.58	122,771.36
N½ SW	24	36,533.10	33,933.86	1,162.04	32,771.82	21,845.36
NW	24	247,296.24	233,470.82	7,672.58	225,798.24	147,873.46
S½ SW	25	52,558.52	49,570.51	1,583.32	47,987.19	31,427.93
W½ NE	26	71,483.47	76,082.15	2,570.69	73,511.46	43,744.31
SE SE	26	36,364.15	48,121.09	1,240.27	46,880.82	21,744.34
SW SE	26	87,341.09	84,135.80	3,030.05	81,095.75	52,226.55
E½ NW	26	220,484.88	210,513.05	6,732.65	203,780.40	131,841.32
S½ SW	26	30,190.54	31,996.96	893.87	31,103.09	18,052.76
W½ NW	26	173,091.36	180,152.98	5,284.97	174,868.01	103,501.85
N½ NE	27	91,713.95	85,634.03	2,738.50	82,895.53	54,841.35
S½ NE	34	70,745.01	70,027.83	2,412.69	67,615.14	42,305.74
N½ SE and N½ SW SE	34	104,735.02	98,349.07	2,935.06	95,414.01	62,627.44
S½ NW	34	17,449.30	16,485.65	499.77	15,985.88	10,434.00
SE	35	250,060.14	235,860.20	8,027.33	227,832.87	149,526.16
NW	35	343,528.52	353,565.60	9,987.92	343,577.68	205,416.59
Group B:						
N½ SW NW	19-40-78	42,719.65	45,090.58	1,187.03	43,903.55	25,544.69
S½ SW NW	19	30,756.69	34,734.92	874.13	33,860.79	18,391.29
SW SE	30	48,025.40	54,529.08	1,406.03	53,123.05	28,717.31
NW SE	30	89,065.06	101,167.40	2,489.31	98,678.09	53,267.41
NE SW and S½ SW	30	130,253.76	143,253.66	3,825.83	139,427.83	77,886.64
NW SW	30	66,549.13	74,328.04	1,837.49	72,490.55	39,793.77
S½ SW NW	30	18,881.69	20,612.49	514.71	20,097.78	11,290.51
NW NW and N½ SW NW	30	128,030.94	145,444.36	3,849.18	141,595.18	76,557.48
Group C:						
S½ NW and NW NW	1-39-79	89,153.22	91,210.51	3,026.95	88,183.56	53,310.13
NE	2	229,964.08	235,620.37	7,937.51	227,682.86	137,509.49
Total Government Lands		3,988,863.11	4,001,358.10	123,072.68	3,878,285.42	2,385,183.78

AGREEMENT 2/1/23 WITH M. O. CO., W. O. F. CO., AND M. R. CO.

50% Undivided Interest:						
W½ 12, NW and N½ SW	13-40-79	224,933.33	224,078.74	6,440.37	217,638.37	134,501.31
S½ SW (Iba 80)	13-40-79	50,698.80	47,466.73	2,047.02	45,419.71	30,315.90
E½	25-40-79	341,172.60	322,567.96	11,053.15	311,514.81	204,007.84
Total Patented Lands		616,804.73	594,113.43	19,540.54	574,572.89	368,825.05
Total		4,605,667.84	4,595,471.53	142,613.22	4,452,858.31	2,754,008.83
SW NW	5-39-78	2,870.37	−6,745.79	439.39	−7,185.18	12,672.99
600 acres in Section 6		31,874.95	7,791.86	1,728.00	6,063.86	49,838.22
A. D. Aitken Tr. Royalty		10,381.34	10,018.10	----------	10,018.10	----------
Total Salt Creek (Excluding Sec. 36)		4,650,794.50	4,606,535.70	144,780.61	4,461,755.09	2,816,520.04

191 *Petitioner's Exhibit 1*

Admitted in Evidence Jan. 31, 1935

This Indenture, Made and Entered into this 24 day of July 1911, by and between Wm. G. Henshaw, and Hetty T. Henshaw, Helen W. Henshaw, Tyler Henshaw, Alla S. Chickering, Harry Chickering, Henry D. Nichols, Ethel K. Nichols, E. M. Hall, Lillie T. Hall, F. W. Henshaw, H. J. Knowles, W. H. Metchalf, A. H. Chickering, C. T. Rodolph, Emil Nusbaumer, P. C. Black, parties of the first part, and The Reed Investment Company, a corporation organized and existing under and by virtue of the laws of the State of Colorado, party or parties of the second part,

Witnesseth, that, for and in consideration of the sum of one hundred dollars ($100.00) and other good and valuable considerations, in hand paid to the parties of the first part by the party or parties of the second part, the parties of the first part have granted, bargained, sold, remised, released and quitclaimed, and by these presents do grant, bargain, sell, remise, release, and quitclaim, unto the party or parties of the second part, its or their successors and assigns, heirs, administrators, and executors, all their right, title, interest, and estate in, to, and of the following described property, to-wit:

First. All oil placer mining claims located or held in the names of the parties of the first part, or any of them, according to the extent of their respective interests therein, situate, lying, and being in what are known as the Salt Creek Oil Fields, in Natrona County, Wyoming;

Second. All the right, title, interest, and estate of the parties of the first part, to the extent of their respective interests therein, in a certain lease heretofore granted by the State of Wyoming to William M. Fitzhugh and by the latter assigned to the Midwest Oil Company, and now held by the latter company, said lease being upon section thirty-six, township forty, range seventy-nine west (S. 36, T. 40, R. 97 W.), in Natrona County, Wyoming;

Third. All interests of the parties of the first part, according to their respective rights therein, in, to, and under a certain agreement

between the Stock Oil Company, a Wyoming corporation, and William M. Fitzhugh, affecting the east half of section twenty-five, township forty, range seventy-nine west (E½, Sec. 25, T. 40, R. 79
192 W.), situate in Natrona County, State of Wyoming, which said agreement was heretofore assigned by said William M. Fitzhugh to and is now held by the Midwest Oil Company;

Fourth. All interest of the parties of the first part, according to their respective interests therein, in, to, and under a certain agreement heretofore entered into between H. E. Stock, J. E. Stock, and other individuals, with William M. Fitzhugh, affecting various oil placer mining claims in Salt Creek Oil Fields, situated in Natrona County, Wyoming; and in

Fifth. All other agreements, if any, made and entered into between the said William M. Fitzhugh, H. E. Stock, J. E. Stock, and other associates, or with any other individuals, persons, or corporations, under or by virtue of which any right, title, interest, or estate has inured, or held to have inured to the benefit of the parties of the first part, or any of them, only in so far as the said agreements may have been made in reference to said Salt Creek Oil Field and also not including the Wyoming Central Association lease transaction.

The intention of this conveyance is to transfer and convey, and it is hereby agreed, that it does transfer and convey unto the party or parties of the second part, all of the right, title, interest, and estate of the parties of the first part, or of any or either of them, in and to any and all of the aforesaid lands in which the parties of the first part, or any or either of them, have or hold, legally or equitably, any interest;

To Have and to Hold the above-described property, together with all the right of the parties of the first part in law and equity therein or thereto, together with all oils, gases, petroleum, and other mineral deposits, located in said premises, unto the party or parties of the second part, its or their successors and assigns, heirs, administrators, and executors, forever.

And parties of the first part further agree, that in the event they acquire any further or additional title to any of the property hereby conveyed, they will hold the same for and convey the same to the party or parties of the second part.

193 In Witness Whereof, the parties of the first part have hereunto set their hands and seals, the day and year first above written.

(s) Wm. G. Henshaw [SEAL]
(s) Hetty T. Henshaw [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) Helen W. Henshaw [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) Tyler Henshaw [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) Alla S. Chickering [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) Harry Chickering [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) Henry D. Nichols [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) Ethel K. Nichols [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) E. M. Hall [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) Lillie T. Hall [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) F. W. Henshaw [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) H. J. Knowles [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) W. H. Metcalf [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) A. H. Chickering [SEAL]
By Wm. G. Henshaw, *her Atty. in Fact.*
(s) C. T. Rodolph [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) Emil Nusbaumer [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*
(s) P. C. Black [SEAL]
By Wm. G. Henshaw, *his Atty. in Fact.*

Parties of the First Part.

_____ _____,
Witnesses to each Signature.

_____ _____ [SEAL]
Trustee for and acting in behalf of
The Reed Investment Company,
Party of the Second Part.

194 State of California, County of Alameda, ss.

Before me, J. L. Meyer, a notary public in and for said county, in the state aforesaid, on this 25th day of July, 1911, per-

sonally appeared Wm. G. Henshaw appearing individually and also as attorney in fact for Hetty T. Henshaw, Helen W. Henshaw, Tyler Henshaw, Ethel K. Nichols, Alla S. Chickering, Harry Chickering, Henry D. Nichols, E. M. Hall, Lilly T. Hall, F. W. Henshaw, H. J. Knowles, W. H. Metcalf, A. H. Chickering, C. T. Rodolph, Emil Nusbaumer, and P. C. Black, said persons being personally known to me to be the persons whose names are subscribed to the foregoing instrument, and thereupon said individuals acknowledged that they, and each of them, made, executed and delivered the said above and foregoing instrument of writing, as their free and voluntary act and deed, and as the free and voluntary act and deed of each of them, for the uses and purposes therein set forth; and said Wm. G. Henshaw thereupon acknowledged to me, that he signed, sealed, executed and delivered the said instrument of writing in behalf of his principals as well as in his own behalf, as their free and voluntary act and deed, and as the free and voluntary act and deed of each of them, acting under a power of attorney from his said principals; all for the uses and purposes therein set forth.

In Witness Whereof, I have hereunto set my hand and notarial seal this 25th day of July 1911. My commission expires March 5, 1913.

[NOTARIAL SEAL] (s) J. L. MEYER,
Notary Public in and for the County of Alameda, State of California.

Before United States Board of Tax Appeals

Praecipe for the record

Filed Dec. 11, 1936

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You will please prepare and transmit to the clerk of the United States Circuit Court of Appeals for the Tenth Circuit within sixty days from the date of filing of the petition for review, as enlarged by appropriate orders of this Board, certified copies of the following documents:

195 (1) The docket entries of the proceedings before the United States Board of Tax Appeals in the above-entitled case:

(2) Original and amended petitions to the United States Board of Tax Appeals and the Commissioner's Answers thereto;

(3) Findings of Fact and Opinion promulgated April 23, 1936;

(4) Decision of the United States Board of Tax Appeals entered June 25, 1936;

(5) Petition for review, including notice of filing of same;

(6) Statement of Evidence as settled or agreed upon, together with the following exhibits or portions of exhibits attached to the Stipulation of Facts:

Exhibit B.
Exhibit C.
Exhibit D.
Exhibit H.
Exhibit I.
Exhibit J.
Portion of Exhibit L–1, as follows:

All of the first page with the exception of the last line referring to the Waiver of Notice. Omit all Waivers of Notice and include balance of the exhibit beginning with the sentence "A written proposal was thereupon presented to the meeting and read to the Directors."

Portion of Exhibit L–2, as follows:

Pages 1, 8, and 9 of the first Deed included therein, omitting all other pages;

Pages 1, 8, and 9 of the second Deed included therein, omitting all other pages;

Pages 1 and 9 of the third Deed included therein, omitting all other pages;

Pages 1, 8, and 9 of the fourth Deed included therein, omitting all other pages; and

196 All of the fifth Deed included therein, consisting of two typewritten pages.

Exhibit N.
Exhibit T–1.
Exhibit T–2.
Exhibit U–1.
Exhibit U–2.
Exhibit U–3.
Exhibit U–4.
Exhibit V.

(7) Petitioner's Exhibit No. 1;

(8) This Praecipe.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Tenth Circuit.

RANDOLPH E. PAUL,
CHARLES B. MCINNIS,
Attorneys for the Petitioner.
Transportation Bldg., Washington, D. C.

Receipt of a copy of the above Praecipe for the Record is hereby acknowledged this 11th day of December 1936.

MORRISON SHAFROTH,
Attorney for Respondent on Review.

[Clerk's certificate to foregoing transcript omitted in printing.]

And thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Tenth Circuit, viz:

Order of submission

Third Day, April Term, Wednesday, April 14th A. D. 1937

Before Honorable ORIE L. PHILLIPS, Circuit Judge, Honorable SAM G. BRATTON, Circuit Judge, and Honorable T. BLAKE KENNEDY, District Judge

This cause came on to be heard, Harold D. Roberts, Esquire, appearing for petitioner, Helen R. Carloss appearing for respondent.

On motion, petitioner was granted leave to file twenty printed copies of a reply brief in this cause instanter, which was accordingly done.

Thereupon argument was commenced by counsel and continued to the hour of adjournment.

Order of submission

Fourth Day, April Term, Thursday, April 15th A. D. 1937

Before Honorable ORIE L. PHILLIPS, Circuit Judge, Honorable SAM G. BRATTON, Circuit Judge, and Honorable T. BLAKE KENNEDY, District Judge

This cause came on further to be heard, Harold D. Roberts, Esquire, appearing for petitioner, Helen R. Carloss appearing for respondent, and argument by counsel was concluded.

Thereupon this cause was submitted to the court.

United States Circuit Court of Appeals, Tenth Circuit

No. 1516. April Term, 1937

MOUNTAIN PRODUCERS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

August 26, 1937

Before PHILLIPS and BRATTON, Circuit Judges, and KENNEDY, District Judge

Harold D. Roberts (Randolph E. Paul and Valentine B. Havens were with him on the brief), for Petitioner.

Helen R. Carloss, Special Assistant to the Attorney General (James W. Morris and Sewall Key were with her on the brief), for Respondent.

KENNEDY, District Judge, delivered the opinion of the Court.

The Board of Tax Appeals upon an appeal from the Commissioner of Internal Revenue assessed a deficiency tax against the petitioner for the year 1925 in the amount of $67,509.13 and the matter is here upon a petition for a review of the Board's decision. The facts were stipulated before the Board and a brief summary of its findings will suffice in determining the applicable principles of law.

In 1925 the petitioner, Mountain Producers Corporation, owned all of the capital stock of the Wyoming Associated Oil Corporation and a consolidated return was filed upon which the deficiency in controversy was determined. The Wyoming Corporation, organized in 1919, held certain placer mining claims, leases and operating agreements in the Salt Creek Oil Field in Natrona County, Wyoming. After the passage of the Oil and Gas Leasing Act of February 25, 1920, its claims were exchanged for Government leases and later exchanges were made with the Midwest Oil Company and the Wyoming Oil Fields Company for the purpose of consolidating the leaseholds into more compact blocks to decrease the necessity for off-set drilling. On February 1, 1923, the Wyoming Associated entered into a contract with the Midwest Refining Company whereby it agreed to sell to the Refining Company all the oil produced by it in the Salt Creek Oil Field and the Refining Company agreed to purchase such oil until January 1934, which contract provided for a sliding scale of prices to be paid for such oil. It was also provided that as a part of the price for the oil purchased under said contract the Refining Company should drill, case and maintain all wells, find and supply water, install and operate pumps when necessary, clean, shoot and otherwise stimulate production, conduct all development and production operations necessary for the protection and conservation of the oil and gas contained therein. It was further provided that the Wyoming Company should give to the Refining Company free use of all storage facilities, pipe lines, buildings and equipment, and free of charge all oil and gas necessary for drilling operations, and that the Refining Company should take delivery of the oil purchased at the outlet gates of the measuring tanks located at or near the wells on the property.

On the same date, February 1, 1923, the Wyoming Associated Oil Corporation and the Midwest Oil Company as the holder of a certain lease from the State of Wyoming which originated in October 1919, covering all of Section 36, Township 40 North of Range 79 West, entered into an agreement by which the Midwest Oil Company was to hold in trust for the benefit of Wyoming Associated an undivided 50 percent interest in the State lease and in the benefits and net proceeds realized therefrom and from all renewals and extensions thereof, whether such renewals or extensions should be

made in the name of the Wyoming Company or in their joint names. The lease from the State of Wyoming to the Midwest Oil Company under date of April 19, 1923, presently involved, covered school lands which had been at the time of admission of Wyoming to the Union turned over and granted to the State for the benefit of its public schools and provided that the lessee should pay to the State a royalty equal to 65 percent of the market value of the oil and gas at the mouth of the wells, or at the option of the State to deliver the equivalent amount of the oil and gas produced. In its execution the oil in kind was taken by the State. The cash payments received as net proceeds of its properties by the Wyoming Associated from the Midwest Refining Company for the year 1925 were $4,606,535.70, and the cost of production by the Refining Company of the oil produced to realize this sum was $2,816,520.04. The net amount received by the Wyoming Associated for the lease of the State school lands under the trust agreement from the Midwest Oil Company was $185,438.83.

The questions arising under the aforesaid situation are two-fold: (1) What is the gross income upon which the depletion allowance of the Wyoming Associated as the Petitioners' affiliate should be determined?; and (2) is the amount which the Wyoming Associated received under the trust agreement with the Midwest Oil Company from its oil and gas lease with the State of Wyoming exempt from tax?

The applicable statute concerning depletion allowance is the Revenue Act of 1926, Sec. 204 (c) (2), reading as follows:

"In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

The petitioner contends that the gross income from its properties during the taxable year consisted of the total cash payments, plus the cost of production by the Refining Company under its contract providing that the production costs should be a part of the purchase price of the oil, but the Board of Tax Appeals determined otherwise and limited the gross income to the cash payments received.

Counsel admit that there are no cases on all fours with the case at bar. The respondent relies strongly upon the case of Helvering v. Twin Bell Syndicate, 293 U. S. 312, where the point involved the inclusion of cash royalty payments as gross income for the purpose of fixing depletion allowance. It was there held that such royalty payments should be excluded from the gross income. It is apparent, however, from the reading of this decision that it involved a different principle than that now before us. The royalty owners themselves were entitled to the depletion allowance as well as the lessee. The pertinent language is found on page 321:

"At all events, as the section must be read in the light of the requirement of apportionment of a single depletion allowance, we are unable to say that the Commissioner erred in holding that for the purpose of computation 'gross income from the property' meant gross income from production less the amounts which the taxpayer was obliged to pay as royalties. The apportionment gives respondent 27½ percent of the royalties they receive. Such an apportionment has regard to the economic interest of each of the parties entitled to participate in the depletion allowance."

A case more applicable in principle to the determination of our question is Boulton v. Heiner, 3 F. Supp. 372. The court there was confronted with the matter of determining whether or not the value of services under contract should be included with cash payments in fixing the cost of stock for the purpose of ascertaining the profit from a sale thereof. The court says, at page 374:

"The plaintiff claims in the present suit that in addition to the amount of money actually paid by him for the stock in question in order to acquire it, he was compelled by his contract with the other incorporators and with the original owners of the properties taken over by the corporations, to expend labor and effort which was worth at least the sum of $17,500. The uncontradicted testimony shows that this service was agreed upon and rendered; that it was worth $17,500; and that plaintiff received no compensation therefor other than by the right to acquire the stock. Under these circumstances it is our opinion that the plaintiff is entitled to claim that the cost of his stock was not merely $11,500, the amount of money paid, but also $17,500, the value of his services rendered pursuant to his agreement."

We see no just or logical reason why the cost of production of the oil here which was made a part of the purchase price should not be added to the cash payments for the purpose of determining the gross income of the Wyoming Associated. Certainly it should be unless pure technicalities of the taxing laws be invoked. Had the Wyoming Company produced the oil at its own expense, its gross income would have been the amount which it received from the oil sold and the only difference would have been that it would have received in cash the proportionate amount which represented the cost of production. Under such conditions there should be no question of its gross income including the oil produced and sold to cover production costs. It cannot logically be less than an element of gross income because the cost of production by another is a component part of the purchase price of the oil. There is no criticism on the part of the Government either as to the fairness of the purchase price or of the cost of production covered by the contract between the Wyoming Associated and the Midwest Refining and therefore it would seem unnecessary to analyze these schedules; nor can any charge be made that there was any effort on the part of the taxpayer

to enter into a contract for the purpose of favorably affecting its tax liability.

The respondent contends that the adoption of the petitioner's theory would result in the allowance of a double deduction in that if the cost of production should be included as gross income it would be deducted as an expense, while under the head of depletion the appropriate percentage of the amount would be deducted a second time. We cannot see the soundness of this theory. If the Wyoming Associated operated its own properties and produced its oil which it sold for cash, the cost of that production would be deducted as of course in arriving at its net income for taxation purposes; but if it produced the oil which it sold where a part of the proceeds were necessarily used to cover the cost of production, its gross income would be the total amount sold for the purpose of computing depletion allowance. The two matters are clearly distinct, one being the determination of net income and the other depletion allowance and are approached by the taxing statutes from entirely different angles. We think that the Board erred in excluding the cost of production which was a part of the purchase price of the oil, from the gross income of the petitioner's affiliate.

With reference to the second question, the Board held that the amount received by the petitioner's affiliate from the net proceeds of the school lease under its trust agreement with the lessee of the State was not exempt from tax. It may be admitted that the decisions of the Supreme Court place cases of this character upon the border line. The members of the court have been far from unanimous in their views in the more recent cases. In Metcalf & Eddy v. Mitchell, 269 U. S. 514, Mr. Justice Stone in speaking for the court at page 522, says:

"Just what instrumentalities of either a state or the federal government are exempt from taxation by the other cannot be stated in terms of universal application. But this Court has repeatedly held that those agencies through which either government immediately and directly exercise its sovereign powers, are immune from the taxing power of the other."

In Burnet, Commissioner, v. Coronado Oil & Gas Co., 285 U. S. 393, it was held that the lands granted by the United States to the State of Oklahoma for the support of common schools, were leased by the State to a private company for the extraction of oil and gas, the State reserving a part of the gross production for the benefit of its public school fund, the lease was an instrumentality of the State and the application of a Federal income tax derived from the lease by the lessee was unconstitutional. It is true that in Burnet, Commissioner, v. A. T. Jergins Trust, 288 U. S. 508, it was held that under an oil and gas lease made by a city to a private party the receipts of the lessee were not exempt from a Federal tax because the subject taxed was remote from any governmental function and

the collection of the tax did not trench upon the immunity of the state as a sovereign. In the opinion, however, the court distinguishes the Coronado case and the case of Gillespie v. Oklahoma, 257 U. S. 501, by the statement that the burden upon the public was there more definite and direct than in the case under consideration. We think that the Coronado case, which has been criticised but never overruled, must through analogy rule the case at bar, unless the situation of the Wyoming Associated is distinguishable from that of the lessee. Such a contention is made by the respondent through reference to the cases of Wanless Iron Co. v. Commissioner, 75 F. (2d) 799 (C. C. A. 8), and Hobart Iron Co. v. Commissioner, 83 F. (2d) 25 (C. C. A. 6). Those cases were distinguished from the Coronado and Gillespie cases, however, upon the ground that sublessees could not claim exemption from tax since the lessee had parted with any direct relationship with the State.

In the case at bar we find the lessee and the taxpayer bound together by a trust agreement entered into before the lease by the State was made by which they were to have equal rights in the lease itself and the net proceeds realized from it in whichever name of the parties the lease or any renewal or extension should stand. In substance and effect the Wyoming Associated was as much a lessee of the lands as was the Midwest Oil Company, the lessee in name. In Central Life Assurance Society v. Commissioner, 51 F. (2d) 939, at page 941, it was said:

"Tax laws are essentially practical in their purposes and application, and the federal income tax laws are no exception. While, for the purpose of convenience and certainty in collection of such taxes, it is sometimes provided that those who collect income for others shall pay therefrom the taxes thereon, yet a cardinal purpose of the income tax laws is to tax the income to the person who has the right or beneficial interest therein and not to throw the burden upon a mere collector or conduit through whom or which the income passes. Shellabarger v. Commissioner, 38 F. (2d) 566, 567 (C. C. A. 7); Young v. Gnichtel, 28 F. (2d) 789 (D. C. N. J.); O'Malley v. Eaton, 24 F. (2d) 436 (D. C. Conn.); also compare U. S. v. Robbins, 269 U. S. 315, 327, 328, 46 S. Ct. 148, 70 L. Ed. 285; Kaufmann v. Commissioner, 44 F. (2d) 144, 146 (C. C. A. 3); Mitchel v. Bowers, 15 F. (2d) 287, 289 (C. C. A. 2). It is also a basic principle in the application of such laws that substance and not mere form be regarded as governing."

Many cases are cited in the briefs in addition to those to which reference herein has been made, but we think they fail to throw any additional light upon the subject under discussion and therefore have not been reviewed.

For the reasons stated, the decision of the Board of Tax Appeals upon both points will be reversed and the case remanded for further proceedings in accordance with this opinion.

PHILLIPS, Circuit Judge, dissenting.

The declaration of trust of February 1, 1923, in part, read:

"Whereas The Midwest Oil Company, a corporation of the State of Arizona, is the holder of a certain lease from the State of Wyoming, dated the 1st day of October 1919,[1] and

"Whereas The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, is entitled to receive the undivided share in the benefits and net proceeds realized by The Midwest Oil Company under said lease and all renewals and extensions thereof, as hereinafter set forth;

"Now, Therefore, In consideration of the premises and in consideration of other good and valuable considerations paid to The Midwest Oil Company by the Wyoming Associated Oil Corporation, said The Midwest Oil Company doth hereby declare that it holds an undivided fifty per cent (50%) interest in said lease and in the benefits and net proceeds to be realized therefrom and all renewals and extensions thereof for the use and benefit of said The Wyoming Associated Oil Corporation, and reserves the beneficial interest in the remaining fifty per cent (50%) thereof to itself."

The contract of February 1, 1923, in part, read:

"This Agreement Made as of the First day of February, A. D. 1923, between The Midwest Oil Company, a corporation of the State of Arizona, and Wyoming Oil Fields Company, a corporation of the State of Wyoming, and The Wyoming Associated Oil Corporation, a corporation of the State of Delaware, parties of the first part, hereinafter called the 'Producing Companies,' and The Midwest Refining Company, a corporation of the State of Maine, party of the second part, hereinafter called the 'Refining Company'; Witnesseth:

"Whereas The Producing Companies among them own in the several fractions hereinafter set forth leases covering the following described lands in the Salt Creek Oil Field, Natrona County, Wyoming, to-wit: * * *

"The so-called 'State School Lease,' * * * held in trust by the Midwest Oil Company for the benefit of The Midwest Oil Company to the extent of an undivided 50 per cent interest and for the benefit of the Wyoming Associated Oil Corporation to the extent of an undivided 50 per cent interest."

The lease of April 19, 1923, from the state of Wyoming to the Midwest Oil Company covering the school section provided that it should not be assigned without the consent and approval of the state. The record does not disclose the consent or approval by the state of any assignment of an interest in the lease to Associated Oil Corporation. It seems to me when regard is had for the substance of the transactions, what Associated Oil Corporation really acquired was a right to share equally with the Midwest Oil Company in the net profits if any, derived from the operation of the lease. The right to manage and operate the lease was vested wholly in the

[1] The school section lease.

Midwest Oil Company. It alone contracted with the state. The state looked to it alone for the performances of the covenants of the lease. If there were no net profits, Associated Oil Company acquired nothing and it was not expressly obligated to contribute to any losses. The tax was laid upon the net profits after they were segregated and divided between the Associated Oil Corporation and the Midwest Oil Company.

Under these circumstances, was the one-half of the net profits, when segregated and paid to the Associated Oil Corporation, immune from federal taxation? The immunity from taxation accorded to governmental instrumentalities is for the protection of the government in its exercise of governmental functions and extends no further than is necessary for that purpose. Indian Territory I. Oil Company vs. Board of Equalization, 288 U. S. 325, 327. The effect of the decisions since Gillespie vs. Oklahoma, 257 U. S. 501, has been to restrict rather than to extend this doctrine of immunity. In Burnet vs. Coronado O. & G. Co., 285 U. S. 393, 398, the court said:

"We are disposed to apply the doctrine of Gillespie vs. Oklahoma strictly and only in circumstances closely analogous to those which it disclosed."

In Fox Film Corp. vs. Doyal, 286 U. S. 123, 128, the court said:

"The principle of the immunity from state taxation of instrumentalities of the Federal Government, and of the corresponding immunity of state instrumentalities from Federal taxation—essential to the maintenance of our dual system—has its inherent limitations. It is aimed at the protection of the operations of government (McCulloch v. Maryland, 4 Wheat. 316, 436), and the immunity does not extend 'to anything lying outside or beyond governmental functions and their exertions.' Indian Motocycle Co. v. United States, 283 U. S. 570, 576, 579. Where the immunity exists, it is absolute, resting upon an 'entire absence of power' (Johnson v. Maryland, 254 U. S. 51, 55, 56), but it does not exist 'where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government.' Willcuts v. Bunn, 282 U. S. 216, 225."

See also Helvering vs. Atlas Life Insurance Co. (C. C. A. 10), 78 F. (2d) 166, 168; Taber vs. Indian Territory I. O. Co., 300 U. S. 1, 3, 4.

In Jaybird Mining Co. vs. Weir, County Treasurer, 271 U. S. 609, an attempt was made to lay an ad valorem tax upon ores mined under a lease of restricted Indian land and in the bins on the land. A tax was assessed on the ores in mass, the royalties or equitable interest of the Indians not having been paid or segregated. The court said: "The lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian Wards," and held that the tax was laid upon a federal governmental instrumentality. However, in the later case of Indian Territory I. O. Co. vs. Board of Equalization, 288 U. S. 325, where an ad valorem tax was

laid upon the lessee's share of the ore produced under a restricted Indian lease after the royalties or equitable interests of the Indian lessors had been segregated and paid to them, immunity was denied. In the latter case the court said:

"There is a recognized distinction between a non-discriminatory tax upon the property of an agent of government, albeit the property is used in, or has relation to, the business of the agency—where there is only a remote, if any, influence upon the exercise of the functions of government—and a tax which is deemed to impose a direct burden upon the exertion of governmental powers."[2]

In Burnet vs. A. T. Jergins Trust, 288 U. S. 508, the city of Long Beach, California, made an oil and gas lease to the Jergins Trust covering part of a tract of land owned by the city and used by it for water supply and other purposes. Under the lease the oil and gas recovered was jointly sold by the parties to the lease and the proceeds were divided in stated proportions between them. The Commissioner of Internal Revenue proposed a deficiency in income taxes on account of the proceeds derived by the Jergins Trust from the sale of oil. The Jergins Trust asserted that the income was immune from taxation. The court said:

"If the respondent is exempt from the exaction the conclusion must follow because the tax directly burdens the functions of the state acting through the city of Long Beach. Considerations which have led to the condemnation of taxes in other circumstances are here absent. The levy is not upon the property of the municipality, nor upon the income it derives from its property, is not upon the city's share of the oil recovered, the lease, or the gross income therefrom. The law measures the assessment by the net income of the respondent, whose operations are carried on in a private and not in a public capacity for the personal gain of its cestuis que trustent. The government asserts that the incidence of the tax is so remote from the activities of the municipality as to have no substantial adverse effect upon them. The respondent insists that as lessee of the lands in question it is a governmental agency and any tax laid upon its income directly burdens governmental functions. * * *

"The application of the doctrine of impied immunity must be practical (Railroad Co. v. Peniston, 18 Wall. 5, 31, 36) and should have regard to the circumstances disclosed. We think that in the present instance the subject of the tax is so remote from any governmental function as to render the effect of the exaction inconsiderable as respects the activities of the city. Compare Alward v. Johnson, 282 U. S. 509, 514. Its collection is not inconsistent with and does not trench upon the immunity of the state as a sovereign. The income of the respondent from the lease is not immune from federal income tax."

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[2] See discussion of these cases in Tabor vs. Indian Territory I. O. Company, 300 U. S. 1, 4, 5.

It has been held that the income derived by a sub-lessee under, or an assignee of a mineral lease from a state of lands owned by the state, is not immune from taxation although the sub-lessee or assignee is required by the terms of the lease to perform the obligations of the lessee under the original lease from the state. Helvering vs. Atlas Life Ins. Co. (C. C. A. 10), 78 F. (2d) 166; Hobart Iron Co. vs. Commissioner (C. C. A. 6), 83 F. (2d) 25 (Cert. denied, 299 U. S. 543); Wanless Iron Co. vs. Commissioner (C. C. A. 8), 75 F. (2d) 779 (Cert. denied, 295 U. S. 765). Here the Associated Oil Company had no direct contractual relation with the state. Its right under the contracts with the Midwest Oil Company was to share in the net proceeds of the lease. The tax was laid upon the Associated Oil Company's share of the net proceeds of the lease after they had been segregated and divided.

It is my opinion that the incidence of the tax is so remote in its influence or effect upon the exercise by the state of its governmental functions as to have no substantial adverse effect upon them. I, therefore, respectfully dissent from so much of the majority opinion as holds that the net proceeds derived by the Associated Oil Company under the declaration of trust of February 1, 1923, are immune from taxation by the federal government. In all other respects I concur in the majority opinion.

A true copy.

Attest:

Clerk, U. S. Circuit Court
of Appeals, Tenth Circuit.

Judgment

Thirty-fourth Day, April Term, Thursday, August 26th, A. D. 1937

Before Honorable Robert E. Lewis and Honorable Orie L. Phillips, Circuit Judges

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the decision of the United States Board of Tax Appeals in this cause be and the same is hereby reversed; and that this cause be and the same is hereby remanded to said United States Board of Tax Appeals for further proceedings in accordance with the opinion of this court.

(On October 1, 1937, the mandate of the United States Circuit Court of Appeals, in accordance with the opinion and judgment of said court, was issued to the United States Board of Tax Appeals.)

Clerk's certificate

United States Circuit Court of Appeals, Tenth Circuit:

I, Albert Trego, Clerk of the United States Circuit Court of Appeals for the Tenth Circuit, do hereby certify that the foregoing contains a full, true and complete copy of the transcript of the record from the United States Board of Tax Appeals, and full, true and complete copies of certain pleadings, record entries and proceedings, including the opinion (except full captions, titles, and endorsements omitted in pursuance of the rules of the Supreme Court of the United States) had and filed in the United States Circuit Court of Appeals for the Tenth Circuit in a certain cause in said Circuit Court of Appeals, No. 1516, wherein Mountain Producers Corporation was petitioner and Commissioner of Internal Revenue was respondent, as full, true and complete as the originals of the same remain on file and of record in my office.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Tenth Circuit, at my office in Denver, Colorado, this 16th day of November A. D. 1937.

[SEAL]

ALBERT TREGO,
Clerk of the United States Circuit Court of Appeals, Tenth Circuit.

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Order allowing certiorari

Filed January 3, 1938

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit is granted, and the case is assigned for hearing immediately following No. 446.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) Enter Attorney General. File No. 42,081. U. S. Circuit Court of Appeals, Tenth Circuit. Term No. 600. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. Mountain Producers Corporation. Petition for writ of certiorari and exhibit thereto. Filed November 26, 1937. Term No. 600 O. T. 1937.

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28962—37

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MOUNTAIN PRODUCERS CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered in this cause on August 26, 1937.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 41–58) is reported in 34 B. T. A. 409. The opinion of the Circuit Court of Appeals (R. 199) is reported in 92 F. (2d) 78.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 26, 1937 (R. 208). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1935.

QUESTIONS PRESENTED

1. Is income which the respondent's affiliate received under a trust agreement with the owner of an oil and gas lease from the State of Wyoming exempt from Federal income tax?

2. The purchaser of all of the oil produced from the oil lands of the respondent's affiliate agreed to pay and paid all production and development expenses in addition to the cash price paid for the oil. Are the purchaser's expenses part of the gross income of the affiliate for purposes of percentage depletion?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 14–16.

STATEMENT

During the calendar year 1925, the tax year in question, the respondent, a Delaware corporation, owned all of the capital stock of, and was thus affiliated with, Wyoming Associated Oil Corporation, a Delaware corporation, hereinafter called Wyoming Associated. The respondent filed a consolidated income tax return for that year upon

which the deficiency involved in this case was determined (R. 42, 69).

Wyoming Associated, immediately after its organization in 1919, obtained deeds, assignments, and conveyances covering certain placer mining claims, patented lands, and interests in oil and gas leases in the Salt Creek Oil Field in Natrona County, Wyoming (R. 42, 70–75). Pursuant to the Oil and Gas Leasing Act of Congress approved on February 25, 1920, Wyoming Associated in 1920 and 1921 exchanged its placer mining claims for Government leases (R. 43, 76) and on or about February 1, 1923, exchanged certain lands and leases for similar property of Midwest Oil Company and Wyoming Oil Fields Company in the Salt Creek Oil Field for the purpose of consolidating leaseholds into more compact blocks to decrease offset drilling (R. 43, 76).

On February 1, 1923, Wyoming Associated and the Midwest Oil Company executed a "Declaration of Trust" which recited that the Midwest Oil Company, owner of a five year lease from the State of Wyoming dated October 1, 1919, and covering all of one section of school land in Natrona County granted to the State by the United States, held an undivided fifty per cent. interest in the lease and in the renewals and extensions thereof and in the benefits and net proceeds to be realized therefrom, for the use and benefit of Wyoming Associated, which agreed to share the obligations of the lease

(R. 43, 146–147). The five year lease here involved from the State of Wyoming to the Midwest Oil Company, dated April 19, 1923, and to begin October 1, 1924, on expiration of the former lease, also covered all of the said section of school land (R. 46–47, 163–170). This lease stated that it was agreed that no assignment should be made without the consent of the State of Wyoming (R. 47, 169). The record does not disclose any assignment of the lease either with or without such consent (R. 55).

The State received its agreed royalty of sixty-five per cent. of the oil produced in kind and the proceeds of the sale of the remaining oil were divided equally between Wyoming Associated and the Midwest Oil Company in 1925 (R. 46).

On the same date, February 1, 1923, Wyoming Associated, Midwest Oil Company, and Wyoming Oil Fields Company entered into a contract (R. 147–154) with the Midwest Refining Company which referred to the declaration of trust and provided that the Midwest Refining Company agreed to buy and the other three companies agreed to sell, until January 1, 1934, all the oil produced from the property in the Salt Creek Oil Field owned or leased jointly by them (except oil used for drilling, domestic or production purposes) upon a sliding scale of prices based on the average price received by the Refining Company for gasoline and kerosene (R. 44, 148–149). The three companies agreed to give the Refining Company free use of all equip-

ment on the property and of all oil and gas reasonably necessary for production operations (R. 44, 150). The Refining Company agreed "as part of the price for oil purchased" to conduct all development and production operations upon the said lands (R. 45, 150–151). The Refining Company agreed to take delivery of the oil purchased at the outlet gates of the measuring tanks located at or near the wells on the property and also agreed that the oil royalties in kind to which some of the tracts of land were subjected were not included in the purchase agreement and would be delivered by the Refining Company to the royalty owners (R. 45–46, 151).[1]

The consolidated return for 1925 filed by the respondent and its affiliate, Wyoming Associated, was on the accrual basis and did not include the income received from the state school land under the declaration of trust of the Midwest Oil Company (R. 42) and did not include as income any amount expended by Midwest Refining Company under the two production contracts dated February 1, 1923. These expenses were not entered on the books of the respondent or of Wyoming Associated as income. The return included in gross income the net prices actually received under the produc-

[1] A separate contract containing similar provisions for the oil lands in the Salt Creek Field owned or leased solely by Wyoming Associated was entered into between Wyoming Associated and the Midwest Refining Company for the same period of time (R. 46, 155–163).

tion contracts. The return computed depletion based on gross income by taking 27½% of the market price of oil in the field at the date of production (R. 48). The tax of $271,342.32 disclosed by the return was paid in five installments in 1926 (R. 48).

In a letter dated March 14, 1929, the Commissioner notified the respondent of a deficiency of $90,642.87 determined for the most part by including in income the amount of $185,438.83 received under the declaration of trust of the Midwest Oil Company, and by reducing the depletion allowance to a percentage of the cash received for oil produced (R. 10–11, 42).

Before the Board of Tax Appeals the respondent urged that the income received under the declaration of trust was immune from tax and that the gross income on which the percentage depletion should be computed with respect to the other oil properties should be (1) either the market value of the oil produced, or (2) the amount of $4,606,535.70 received under the contracts for oil purchased plus the operating expenses of the Midwest Refining Company in the amount of $2,816,520.04 (R. 28, 42, 189). It also urged that in lieu of percentage depletion the Commissioner should have allowed depletion based upon cost (R. 23, 42).

The Board of Tax Appeals held that (1) gross income of Wyoming Associated for purposes of computing depletion did not include expenses of

the Midwest Refining Company; (2) income under the trust agreement from the state school land is not exempt from Federal income taxation; and (3) depletion based on gross income, excluding expenses of Midwest Refining Company, or on cost, whichever was greater, should be recomputed (R. 49–58). Thereupon the deficiency was reduced to $67,509.13, apparently for the reason that cost depletion of some leases exceeded percentage depletion (R. 58–59).

The Circuit Court of Appeals reversed the Board on both issues and held that respondent's gross income for calculation of depletion included the operating expenses of Midwest Refining Company and that the income from the school land lease was exempt. Circuit Judge Phillips dissented with an opinion on the second issue (R. 205).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the income received by Wyoming Associated under the trust agreement with the Midwest Oil Company from the lease of state school lands is exempt from Federal income taxes.

2. In holding that gross income of Wyoming Associated for the computation of percentage depletion should include not only the cash received for oil sold but also the expenses of the purchaser incurred in the production of the oil pursuant to the purchase agreements.

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REASONS FOR GRANTING THE WRIT

1. In holding that the income received by the respondent's subsidiary, Wyoming Associated, under the trust agreement with the lessee of the state school lands, was immune from Federal taxation, the Circuit Court of Appeals, we believe, misapplied and improperly extended *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, to this case in which the subsidiary was not the lessee of the state lands and had direct contractual relations only with the private lessee of the state lands. In *Burnet* v. *Coronado Oil & Gas Co., supra,* this Court held that the income of a *lessee* from a lease of school lands from the State of Oklahoma was exempt from Federal income taxes, but stated at page 398 that this Court was disposed to apply the doctrine of *Gillespie* v. *Oklahoma,* 257 U. S. 501, there involved, "strictly and only in circumstances closely analogous to those which it disclosed." Cf. *Burnet* v. *A. T. Jergins Trust,* 288 U. S. 508, 516. In the instant case, as pointed out in the dissenting opinion of Judge Phillips, neither the respondent nor its affiliate, Wyoming Associated, dealt directly with the State of Wyoming but dealt solely with the State's lessee, Midwest Oil Company.

The decision of the court below is in substantial conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Bankline Oil Co.* v. *Commissioner,* 90 F. (2d) 899, in which the taxpayer's petition for certiorari was granted October

25, 1937, No. 388, October Term, 1937, and was not opposed by the Government because of the conflict with the present case. In the *Bankline* case the Circuit Court of Appeals held that income of the assignee of an oil lease of tide lands from the State of California was not exempt from Federal income taxation, and followed *Burnet* v. *A. T. Jergins Trust, supra.* We do not believe that the fact that the State of Wyoming in the present case received the lands from the United States in trust for purposes of a public school system and that California in the *Bankline* case held the tide lands there involved as sovereign on an implied trust for the people of the State presents a controlling distinction.

In addition to the *Bankline* case other decisions have refused to extend the rule of immunity of the *Coronado* case to income derived by an assignee of such a lease from sublessees, *Wanless Iron Co.* v. *Commissioner,* 75 F. (2d) 779 (C. C. A. 8th); to income from sale of such leases, *Marland* v. *United States,* 53 F. (2d) 909 (C. Cl.) or to income from rent of buildings on the leased lands, *Metropolitan Bldg. Co.* v. *United States,* 12 F. Supp. 537 (C. Cl.).

2. The decision of the court below that gross income of the respondent's affiliate for computation of percentage depletion includes, in addition to the cash contract purchase price of $4,606,535.70 received for the oil sold, also the sum of $2,816,520.04 expended under the contract by the purchaser to

produce the oil, conflicts in principle with *Signal Gasoline Corp.* v. *Commissioner,* 66 F. (2d) 886 (C. C. A. 9th). In the *Signal* case the court held that the purchaser of wet gas, under a contract for which a very valuable consideration was paid and in which the purchaser agreed to assist and thereafter did assist in production of wet gas by installation and operation of machinery for that purpose at great expense, did have a right to share in the wet gas produced and, consequently, a depletable interest which might be proved. On a second appeal, 77 F. (2d) 728, certiorari denied, 296 U. S. 657, the court held that the difference between market value and contract price of wet gas was purchaser's depletable interest and that the purchaser had failed to prove any such difference. In the instant case also the purchaser under the contract conducted the production operations and paid production expenses.

Although in the present case it is not contended that the contract gives a depletable economic interest in the oil lands to the purchaser, it may be noted that the decision of the court below gives the entire allowance to respondent, the vendor, and in effect excludes the purchaser from any possible depletion allowance, and the decision, therefore, presents a conflict in principle with the decisions of the Circuit Court of Appeals for the Ninth Circuit in the *Signal* case, *supra,* whatever may be the validity of that decision, and in *Bankline Oil Co.* v. *Com-*

missioner, 90 Fd. (2d) 899, Government's petition for certiorari granted October 25, 1937, October Term 1937, No. 387. Cf. *Thomas* v. *Perkins,* No. 824, October Term, 1936, decided June 1, 1937; *Palmer* v. *Bender,* 287 U. S. 551; *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 320–321; *Commissioner* v. *O'Donnell,* 90 F. (2d) 907, certiorari granted October 25, 1937, October Term 1937, No. 406.

In the *Bankline* case the question is whether the purchaser of wet gas from oil producers at a contract price below market price has a depletable interest in the gas in place under a contract which did not require either the purchaser or the seller to produce wet gas from the ground.

The production expense of the purchaser was not gross income of the seller, respondent's affiliate, within the statutory (Sec. 213 of Revenue Act of 1918) or any other definition of gross income. The statement in the contract that the purchaser agreed to conduct production operations "as part of the price for oil purchased" (R. 45, 150–151) does not alter the fact that actually the purchaser under the contract agreed to bear and did bear production expenses in consideration for the seller's promise to sell all of the oil produced at a price much less than market price. The production services were promised and rendered in consideration for this valuable promise of the seller and not as part of the purchase price of the oil. This is made clear by

the fact that if no oil had been produced the services could not have been paid for in oil and, therefore, either would not be paid for at all by the seller or, as is more likely, were paid for by the seller's promise to sell all oil produced at a price less than market price. Moreover, the cost or value of the purchaser's services were not gross income of the seller because the purchaser performed the services for its own benefit.

This amount was never received by the respondent's affiliate and was never entered in its books or in the respondent's books or in the income tax return as gross income. The return included in gross income from these properties only the amount received on the sale of the oil and not these expenses (R. 48). The sum of these two amounts is not the statutory gross income intended by Congress. Cf. *Crews* v. *Commissioner*, 89 F. (2d) 412 (C. C. A. 10th); *Consumers Natural Gas Co.* v. *Commissioner*, 78 F. (2d) 161 (C. C. A. 2d), certiorari denied, 296 U. S. 634. The Government submits that by this provision of the contract whereby the purchaser paid production expenses the respondent's affiliate chose a method of production and sale of oil in which the cost of production was not part of its statutory gross income for purposes of depletion. The two methods are sufficiently different to require different tax treatment in this respect.

3. The two questions are important. The correctness of this extension of the implied constitutional immunity from Federal income taxation to income received under the agreement not with the State but with the lessee of state school lands should be determined. The contract under which the purchaser of oil pays the production expenses is common in the oil business, and the question of including those expenses in the vendor's gross income for percentage depletion may be expected to arise in a number of other cases.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for certiorari should be granted.

STANLEY REED,
Solicitor General.

NOVEMBER 1937.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall be depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid,

or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commssioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may

deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 600

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MOUNTAIN PRODUCERS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 38–45) is reported in 34 B. T. A. 409. The opinion of the Circuit Court of Appeals (R. 152–160) is reported in 92 F. (2d) 78.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 26, 1937 (R. 160). The petition for a writ of certiorari was filed November 26, 1937, and was granted January 3, 1938 (R. 162). The jurisdiction of this Court rests on Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the income which the respondent's affiliate received under a trust agreement with the owner of an oil and gas lease from the State of Wyoming is exempt from Federal income tax.

2. Whether the production expenses paid by the purchaser of all the oil produced from the oil lands of the respondent's affiliate are gross income from the property of the respondent's affiliate in addition to the cash price paid for the oil.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 56–60.

STATEMENT

The facts as stipulated (R. 53–145) and as found by the Board of Tax Appeals (R. 33–38) are substantially as follows:

During the calendar year 1925, the tax year in question, the respondent, a Delaware corporation, owned all the capital stock of, and was thus affiliated with, Wyoming Associated Oil Corporation, a Delaware corporation, hereinafter called Wyoming Associated. The respondent filed a consolidated income tax return for that year upon which the deficiency involved in this case was determined (R. 33).

In 1910 one Fitzhugh obtained a lease dated January 4, 1910 (R. 141–144), from the State of Wyoming, covering a section of school land. He held this lease, among others, for the benefit of a mining partnership of which he was a member (R. 54). In 1911 Fitzhugh and one other partner transferred their undivided interests to the Midwest Oil Company, hereinafter called Midwest (R. 54).

The State leased this school land for five year terms and on December 31, 1914, the Fitzhugh lease expired. Thereafter Midwest made successive leases commencing on January 1, 1914, October 1, 1919, and October 1, 1924. None of the leases contained an option or privilege of renewal (R. 125–144). Each lease provided that it could not be assigned without the consent and approval of the State (R. 129, 135, 140, 143). The 1924 lease, applicable to the tax year in question, 1925, provided that a royalty of 65 per cent. of the oil and gas produced should be paid to the State (R. 125–126).

After a series of transfers of their interests by the other partners of Fitzhugh and their successors, Wyoming Associated, immediately after its organization in 1919, received these interests for its capital stock (R. 54–58). It received at that time various deeds, assignments, and conveyances covering certain placer mining claims, patented lands, and interests in oil and gas leases in the Salt Creek Oil Field in Natrona County, Wyoming (R. 33). Pursuant to the Oil and Gas Leasing Act of Congress, approved on February 25, 1920, Wyoming Associ-

ated in 1920 and 1921 exchanged its placer mining claims for Government leases (R. 33) and on or about February 1, 1923, exchanged certain lands and leases for similar property of Midwest and of Wyoming Oil Fields Company in the Salt Creek Oil Field for the purpose of consolidating leaseholds into more compact blocks to decrease offset drilling (R. 58–59).

On February 1, 1923, Wyoming Associated and Midwest executed a "Declaration of Trust" (R. 111–112), which recited that the Midwest was owner of the five year lease of school land from the State dated October 1, 1919, covering all of the one section of school land in Natrona County granted to the State by the United States. The instrument declared that Midwest held an undivided fifty per cent. interest in the lease, and in the renewals and extensions thereof and in the benefits and net proceeds to be realized therefrom, for the use and benefit of Wyoming Associated, which agreed to share the obligations of the lease. The lease here involved is the one dated April 19, 1923, which ran for five years from October 1, 1924, when the former lease expired. It also covered all of the same section of school land. The record does not disclose any assignment of the lease, either with or without the consent of the State which was required by the terms of the lease.

The State received its agreed royalty of 65 per cent. of the oil produced in kind in 1925 and the

proceeds of the sale of the remaining oil were divided equally between Wyoming Associated and Midwest (R. 35).

On the same day as the "Declaration of Trust," February 1, 1923, Wyoming Associated, Midwest, and Wyoming Oil Fields Company entered into a contract (R. 113–118) with the Midwest Refining Company, hereinafter called the Refining Company, which referred to the declaration of trust and provided that the Refining Company agreed to buy and the other three companies agreed to sell, until January 1, 1934, all the oil produced from the property in the Salt Creek Oil Field owned or leased jointly by them (except oil used for drilling, domestic or production purposes) upon a sliding scale of prices based on the average price received by the Refining Company for gasoline and kerosene. The three companies agreed to give the Refining Company free use of all equipment on the property and of all oil and gas reasonably necessary for production operations (R. 115). The Refining Company agreed "as part of the price for oil purchased" to conduct all development and production operations upon the said lands (R. 115). The Refining Company agreed to take delivery of the oil purchased at the outlet gates of the measuring tanks located at or near the wells on the property and also agreed that the oil royalties in kind to which some of the tracts of land were subjected were not included in the purchase agreement and

would be delivered by the Refining Company to the royalty owners (R. 115–116).[1]

The consolidated return for 1925 filed by the respondent and its affiliate, Wyoming Associated, was on the accrual basis and did not include as income any amount expended by the Refining Company under the two production contracts dated February 1, 1923 (R. 37). These expenses were not entered on the books of the respondent or of Wyoming Associated as income. The return included in gross income the net prices actually received under the production contracts. The return computed depletion based on gross income by taking 27½ per cent. of the market price of oil in the field at the date of production (R. 37). The tax of $271,342.32 disclosed by the return was paid in five installments in 1926 (R. 37).

In a notice dated March 14, 1929 (R. 6–9), the Commissioner notified the respondent of a deficiency of $90,642.87 determined for the most part by including in income the amount of $185,438.83 received under the declaration of trust of Midwest and by reducing the depletion allowance to a percentage of the cash received for oil produced.

Before the Board of Tax Appeals the respondent urged that the income received under the declara-

[1] A separate contract containing similar provisions for the oil lands in the Salt Creek Field owned or leased solely by Wyoming Associated was entered into between Wyoming Associated and the Refining Company for the same period of time (R. 118–123).

tion of trust was immune from tax and that the gross income on which the percentage depletion should be computed with respect to the other oil properties should be (1) either the market value of the oil produced, or (2) the amount of $4,606,535.70 received under the contracts for oil purchased plus the operating expenses of the Refining Company in the amount of $2,816,520.04 (R. 22, 32, 145). It also urged that in lieu of percentage depletion the Commissioner should have allowed depletion based upon cost (R. 22, 32).

The Board of Tax Appeals held that (1) gross income of Wyoming Associated for purposes of computing percentage depletion did not include expenses of the Refining Company; (2) income under the trust agreement from the state school land is not exempt from Federal income taxation; and (3) depletion based on gross income, excluding expenses of Refining Company, or on cost, whichever was greater, should be recomputed (R. 38–45). Thereupon the deficiency was reduced to $67,509.13, apparently for the reason that cost depletion of some leases exceeded percentage depletion (R. 45).

The Circuit Court of Appeals reversed the Board on both issues and held that respondent's gross income for calculation of depletion included the operating expenses of the Refining Company and that the income from the school land lease was exempt. Circuit Judge Phillips dissented with an opinion on the second issue (R. 151–160).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the income received by Wyoming Associated under the trust agreement with the Midwest Oil Company from the lease of state school lands is exempt from Federal income taxes.

2. In holding that gross income of Wyoming Associated for the computation of percentage depletion should include not only the cash received for oil sold but also the expenses of the purchaser incurred in the production of the oil pursuant to the purchase agreements.

SUMMARY OF ARGUMENT

I

A. The respondent's affiliate is not exempt from taxation under the rule of *Gillespie* v. *Oklahoma,* 257 U. S. 501, and *Burnet* v. *Coronado Oil & Gas Co.,* 285 U. S. 393. These cases confer immunity on the *lessee* of government lands. It is plain that Wyoming Associated was not a lessee of the lands in question. The fact that the Midwest Oil Company declared that it held 50 per cent. of the lease and its net proceeds in trust for Wyoming Associated did not give rise to any rights against or obligations to the State, nor was any income received by Wyoming Associated from the State or from the operation by it of state property. To subject Wyoming Associated to Federal taxation would in no manner interfere with the functions of the State. Its status was essentially equivalent

to the one who sells goods to a government contractor, *Trinityfarm Co.* v. *Grosjean,* 291 U. S. 466, or to the lessee who seeks to escape a property tax after the royalty to the government has been paid, *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325.

B. If, notwithstanding these considerations, the Court should think the rule of the *Gillespie* and *Coronado* cases applicable here, it must then consider whether these cases can be reconciled with subsequent decisions of this Court.

Group No. 1 Oil Corp. v. *Bass,* 283 U. S. 279, and *Burnet* v. *A. T. Jergins Trust,* 288 U. S. 508, have refused to follow the *Gillespie* and *Coronado* cases; and the distinctions made seem not to be related to the basis of the rule of intergovernmental tax immunity. Each of the reasons advanced in the *Gillespie* and *Coronado* cases for granting the exemption has expressly been rejected by the Court. Moreover, these decisions seem contradicted by the principle of *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, holding that immunity to property taxation vanishes after the state royalty has been paid.

Not only are these cases repudiated by subsequent decisions, but they seem contrary to the basic reasons for granting immunity. The lessee of government lands is not serving the sovereign but seeking a private profit. He realizes this profit in a private transaction. To exempt him from a non-discriminatory tax is to give him a special ad-

vantage. Even if this advantage should be reflected in a special advantage to the government lessor, this favored position is not necessary to maintain the sovereign independence of the Nation or the States.

II

A. The production operations of the Refining Company were not gross income of Wyoming Associated. These operations were conducted by the Refining Company for its own benefit and to obtain oil at the cash contract price. Wyoming Associated never treated the production operations as its income either in its books or in the income tax return. Wyoming Associated might have obtained a larger cash price for the oil and, therefore, a larger gross income if it had performed and paid for the production operations. But it did not choose to engage in the business of producing oil. The fact that it might have done business in another manner is no reason for constructing an artificial gross income by adding to the price actually received a value of production operations by the Refining Company for its own benefit. Congress did not intend that "gross income from the property" for percentage depletion should be determined in such a manner. The optional method of cost depletion is available to the respondent if the cash gross income received is not considered sufficient.

B. Even if the Refining Company's production operations have some value to Wyoming Associated which may be considered in computing its gross income, the total field operating expense of the Refining Company is not a correct measure of the value of the operations to Wyoming Associated. The operations were performed also for the benefit of the Refining Company and part of their total value may be allocable to the Refining Company. A part of the operations may have produced no oil and, therefore, may have been a loss and valueless to Wyoming Associated.

C. The Government contends that the sole depletable gross income was the cash price received for the oil and does not contend that the Refining Company has a depletable interest. It is to be noted, however, that the respondent's contention would leave no depletable interest for the Refining Company.

ARGUMENT

I

THE RESPONDENT'S AFFILIATE IS NOT EXEMPT FROM FEDERAL INCOME TAX ON THE SHARE OF INCOME RECEIVED FROM THE STATE SCHOOL LEASE UNDER ITS AGREEMENT OF TRUST WITH THE MIDWEST OIL COMPANY

A. *Respondent's Affiliate was not a Lessee of the State School Lands and so is not Exempt from Federal Taxation*

In 1910 one Fitzhugh entered into an oil lease, covering the school land in question, with the State

of Wyoming (R. 141). He held this lease, among others, for the benefit of a partnership of which he was a member; the other members similarly held other leases in their own names. In 1911 Fitzhugh and one other partner transferred their undivided interests to Midwest (R. 54). After a series of transfers by the other partners (R. 54–57), Wyoming Associated was organized on July 11, 1919, to hold and develop a variety of interests in different oil leases, including an interest, corresponding to the interest of the other members of the Fitzhugh partnership, in a lease of this school land (R. 57–58). On October 1, 1923, Midwest and Wyoming Associated entered into a "Declaration of Trust" under which Midwest held an undivided one-half interest in the benefits and net proceeds of the state lease, and its extensions and renewals, for the benefit of Wyoming Associated (R. 111).

The State leased this school land for five year terms. The Fitzhugh lease ran to December 31, 1914. Thereafter successive leases were made to Midwest commencing, respectively, on January 1, 1914, October 1, 1919, and October 1, 1924. None of the leases contained an option or privilege of renewal (R. 125, 131, 136, 141). Each lease contained a provision that it could not be assigned without the consent and approval of the State (R. 129, 135, 140, 143). The 1924 lease, applicable to the taxable year in question, 1925, provided that a royalty of 65 per cent. of the oil and gas produced should be paid to the State in kind (R. 125–126).

On February 1, 1923, Midwest, Wyoming Associated, and another producing company entered into a contract (R. 113–118) with the Refining Company, covering four leases, including the state lease. Under this contract the Refining Company agreed to produce the oil, to deliver to the lessors any royalties to be paid in kind, and to purchase the remainder at the outlet gates of the measuring tanks at a sliding scale of prices. The contract was to run until January 1, 1934 (R. 113–118). The Refining Company delivered the royalty oil to the State, and paid one-half of the purchase price of the remainder to Midwest and one-half to Wyoming Associated. A representative to check the production was kept at the field by Wyoming Associated (R. 35).

The court below held the income of Wyoming Associated to be exempt from federal taxation under the rule of *Gillespie* v. *Oklahoma*, 257 U. S. 501, and *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393. It is unnecessary to consider whether these decisions can be reconciled with other and later decisions of this Court, notably *James* v. *Dravo Contracting Co.*, No. 3, October Term, 1937, because, even under the *Gillespie* and *Coronado* cases, Wyoming Associated is not exempt from taxation.

1. In the *Gillespie* case this Court stated that "It is agreed that *the lessee* was an instrumentality used by the United States in carrying out duties to the Indians that it had assumed, and that the

only question in the case is whether he is liable to" the State income tax (257 U. S. at 504; italics added). In the *Coronado* case the Court held that "the lease to the respondent was an instrumentality of the State * * *. To tax *the income of the lessee* arising therefrom would amount to an imposition upon the lease itself" (285 U. S. at 400–401; italics added). The decision in each case confines the exemption to the lessee of the state lands.

It must be remembered that the rule of the *Gillespie* and *Coronado* cases is not one to be given a wide and general application, but, on the contrary, is one to be applied only within a very narrow field. Three Justices dissented in the *Gillespie* case; four dissented in the *Coronado* case. In the latter case the majority of the Court declared (285 U. S. at 398):

> We are disposed to apply the doctrine of *Gillespie* v. *Oklahoma* strictly and only in circumstances closely analogous to those which it disclosed.

This statement was repeated in *Burnet* v. *A. T. Jergins Trust,* 288 U. S. 508, 516. It seems clear that the case at bar is not closely analogous to the facts of the *Gillespie* and *Coronado* cases. Neither the reason underlying these decisions nor any language found in the opinions warrants their extension to confer immunity from taxation upon persons who derive their income, not from the State and not from any lease entered into with the State by the

taxpayer, but only by virtue of a contractual arrangement with the lessee of the state lands.

2. It seems plain that Wyoming Associated was not a lessee of state lands and is not entitled to share in any immunity from taxation which may be granted to such lessees.

a. The state lease was made with Midwest, and contained a provision that it could not be assigned without the consent of the State. The record contains no evidence that the consent of the State to an assignment was either sought or obtained. Wyoming Associated has a claim to the oil or the proceeds only by virtue of its agreement with Midwest. The State has given Wyoming Associated no rights, and Wyoming Associated has assumed no obligations toward the State. They are, so far at least as this lease is concerned, strangers to one another. The court below, in granting exemption from federal income taxation to such a corporation has made a startling extension of the doctrine of intergovernmental tax immunity.

It is evident that there can be no claim that Wyoming Associated was itself an instrumentality of the State. Its only claim to tax immunity rests on the "Declaration of Trust" made by the Midwest Oil Company, to the effect "that it holds an undivided fifty per cent. (50%) interest in said lease and the benefits and net proceeds to be realized therefrom." The preceding paragraph of the trust instrument states the beneficial interest of Wyoming Associated as relating only to "the benefits and

net proceeds realized by the Midwest Oil Company." Wyoming Associated was to "share all of the burdens and obligations hereafter accruing under said lease" (R. 111–112).

It is unnecessary to decide whether this instrument creates a trust interest in the lease or only in the net proceeds.[2] In neither case does Wyoming Associated derive its income from the State or from the state oil land. The income is paid over only by virtue of contractual arrangements with the lessee of the state land. Immunity from taxation is not to be controlled by the attorney's choice of words in the instrument by which the lessee promises to share its net income. The important thing is that Wyoming Associated was not a lessee of the state lands, nor was it an assignee of the lease. Its rights and duties ran only to the Midwest Oil Company. As Judge Phillips, dissenting below, said (R. 160), Wyoming Associated "had no direct con-

[2] It should, however, be noted that Midwest and Wyoming Associated viewed the "Declaration of Trust" as something different from a joint ownership of the lease. The agreement of February 1, 1923, made by Midwest, Wyoming Associated, and another producer with the Refining Company, covered four leases. Three of them were described as "owned an undivided 50 per cent" by Wyoming Associated and "an undivided 50 per cent by" Midwest or the other producer. The state lease, however, was not so described, but was said to be "held in trust by The Midwest Oil Company for the benefit of" Midwest "to the extent of an undivided 50 per cent interest and for the benefit of" Wyoming Associated "to the extent of an undivided 50 per cent. interest" (R. 113).

tractual relation with the State. Its right under the contracts with Midwest was to share in the net proceeds of the lease. * * * the incidence of the tax is so remote in its influence or effect upon the exercise by the State of its governmental functions as to have no substantial adverse effect upon them."

The court below based its decision upon the proposition (R. 156):

> In the case at bar we find the lessee and the taxpayer bound together by a trust agreement entered into before the lease by the State was made by which they were to have equal rights in the lease itself and the net proceeds realized from it in whichever name of the parties the lease or any renewal or extension should stand. In substance and effect the Wyoming Associated was as much a lessee of the lands as was the Midwest Oil Company, the lessee in name.

The court thus seems to attach significance to the fact that the "declaration of trust" was entered into prior to the time that Midwest leased the land from the State. Whatever might be the status of Wyoming Associated had it been a joint-lessee, the fact remains that it was not a lessee of any nature. It purchased the right to share in the profits realized by Midwest by surrendering more or less similar interests which it or its predecessors had possessed since the original Fitzhugh lease. But the fact that the interest of Wyoming Associated was one of long standing does not serve to establish a

relationship with the State. Just as fully as though the interest had been purchased after the lease had been made, Wyoming Associated derived its income only by virtue of its contract with Midwest.

The fact that the declaration of trust agreed, as between the parties, that Wyoming Associated was to hold a one-half interest in trust for Midwest Oil Company *if* any "renewal or extensions" of the lease were made in the name of Wyoming Associated, or in their joint names (R. 112), is immaterial. The contingency contemplated by the provision did not occur, and Wyoming Associated did not become a lessee of the State oil land.

b. It has been held that a federal tax upon the net income of a lessee is an unconstitutional interference with the State. The reason for this rule appears to be the fear that the freedom to make leases, or the amount of the royalties received, might be impaired by subjecting the lessee to federal taxation. See *Gillespie* v. *Oklahoma, supra,* 506. This reason has no application to this case. If the income of Wyoming Associated were subject to federal taxation because it was not the lessee of the State lands, but merely the possessor of rights against the lessee, the reasoning of the *Gillespie* case might lead to the conclusion that the freedom of the lessee to dispose of tax-exempt income would be impaired. But this would not affect the State at all except as this inhibition resulted in an unwillingness of oil producers to make leases under these circumstances. The conclusion of the court

below must thus be rested on the following line of reasoning: (1) to tax Wyoming Associated on the income realized under the declaration of trust hampers the lessee in disposing of the income realized from the trust; (2) if the lessee cannot confer tax immunity as well as the income from the lease on the beneficiary of such a trust, the income is of less economic advantage to the lessee; (3) the prospective lessee will accordingly exact more onerous terms from the lessor State; (4) this in turn will interfere with the essential governmental functions of the State; and, finally, (5) each of these possibilities will be so nearly certain and so serious an influence as to compel the conclusion that the Constitution forbids the tax. It needs no elaboration to demonstrate that this chain of hypothetical consequences is wholly speculative and unreal. It follows that there is no reason, in logic or experience, why Wyoming Associated should be exempt from federal taxation. And, as this Court has frequently pointed out, the doctrine of tax immunity is limited by its reason. *National Bank* v. *Commonwealth,* 9 Wall. 353, 362; *Board of Trustees* v. *United States,* 289 U. S. 48, 59; *Helvering* v. *Powers,* 293 U. S. 214, 224–225; *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, 328; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523.

These principles have been applied by the Circuit Court of Appeals for the Sixth Circuit in a closely related situation. In *Hobart Iron Co.* v. *Commissioner,* 83 F. (2d) 25, certiorari denied, 299

U. S. 543, the court held that the sublessee of mineral lands leased by the State of Minnesota was subject to income taxation by the federal government. The court said (p. 26):

> The tax was levied, not upon the property of the state nor upon the income the state derived from its property, but upon the net income of a private corporation derived from the sale of ore which the corporation had acquired under contract with private persons. We think the principles announced in *Burnet* v. *A. T. Jergins Trust* are applicable.

Here Wyoming Associated made no payments to the State, as did the sublessee in the *Hobart Iron* case. It did not operate the property, as did the Hobart Iron Company. There is, accordingly, even less reason to apply the *Gillespie* and *Coronado* rule in the present case, where Wyoming Associated is a complete stranger to the State and where the income from the lease is derived without its aid.

3. This Court has not hitherto decided the precise question here presented. But its decisions in related fields offer instructive parallels.

a. Without questioning the decisions in *Panhandle Oil Co.* v. *Knox,* 277 U. S. 218, and *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, this Court has held that sales to a federal contractor may be taxed by the State, *Trinityfarm Co.* v. *Grosjean,* 291 U. S. 466, and that the Federal Government may tax the transportation of goods shipped by a vendor to a purchasing county of a State, *Wheeler*

Lumber Co. v. *United States,* 281 U. S. 572. The ground of these decisions was that the tax was not laid on the Government itself nor was it laid on the transaction with the Government.

Similarly, without questioning the principle that the State was unable to tax the income of government bonds, this Court held in *Willcuts* v. *Bunn,* 282 U. S. 216, 227, that:

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds.

In *Marland* v. *United States,* 3 F. Supp. 611 (C. Cls.), certiorari denied, 290 U. S. 658, and *Rice Oil Co.* v. *United States,* 7 F. Supp. 414 (D. Mont.), the rule of *Willcuts* v. *Bunn* was applied in the case of oil leases from a State which were assigned by the lessees at a profit.

This Court, in sustaining a tax which concededly would result in added costs to the Government, has succinctly phrased the guiding principles in *James* v. *Dravo Contracting Co., supra.* It said (pamphlet p. 10, citations omitted):

> The tax is not laid upon the Government, its property or officers. * * *
>
> The tax is not laid upon an instrumentality of the Government. * * * Re-

> spondent is an independent contractor. The tax is non-discriminatory.

These principles are fully applicable here. Even if the income derived by the Midwest Oil Company from the oil lease be exempt from federal taxation, this exemption from a non-discriminatory tax does not extend to Wyoming Associated, which has no relation, contractual or otherwise, with the State.

The lower federal courts have applied these principles, not only to refuse exemption to the income derived by the sublessee of state lands (*Hobart Iron Co.* v. *Commissioner, supra,* pp. 19–20), but to deny a claim of immunity when raised by the lessee himself. In *Wanless Iron Co.* v. *Commissioner,* 75 F. (2d) 779 (C. C. A. 8th), certiorari denied, 295 U. S. 765, the court held that the royalty paid by a sublessee to the assignee of a lessee of mining lands owned as school lands by the State of Minnesota was not exempt from federal taxation. This was held to result because the subleases (p. 782):

> are distinct, separate contracts, to which the state of Minnesota is not a party, and the tax here is measured by the net income of the taxpayer arising from its operations in a private capacity for private gain. The sublessees agree to pay the petitioner royalties, and it thus obtained a profit from the sublessees' operation of the mines.

Similarly, the lessee of state lands who erects a building and rents office space has several times been held subject to federal taxation on the income so realized. *Helvering* v. *Atlas Life Ins. Co.,* 78

F. (2d) 166 (C. C. A. 10th); *Eckstein* v. *United States,* 10 F. Supp. 231 (C. Cls.), certiorari denied, 296 U. S. 582; *Metropolitan Building Co.* v. *United States,* 12 F. Supp. 537 (C. Cls.), certiorari denied, 297 U. S. 713.

b. The question may be viewed from another angle. In *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, an *ad valorem* state tax on ores mined under a lease of Indian lands, and held in bins prior to payment of the agreed royalty was held invalid. Yet in *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, the Court, without questioning the *Jaybird* case, sustained an *ad valorem* tax on oil held in storage by the lessee of Indian lands because the tax was imposed after the payment of the royalties. "Payment had been made for the share of the Indian lessors and they had no further interest in the oil" (288 U. S. at 327). See, also, *Taber* v. *Indian Territory Co.,* 300 U. S. 1, 4–5.

So, too, in this case, Wyoming Associated had a claim to the income from the lease only after the royalties had been paid to the State. Even if it be thought that the Midwest Oil Company, as the lessee, realized its income by operations prior to the payment of the royalty to the State, this does not apply to Wyoming Associated. The lease contemplated that Midwest would (1) extract the oil, (2) deliver 65 per cent. of it to the State, and (3) sell it. Only after these three steps had been taken would Wyoming Associated be paid its share of the benefits and net proceeds. It results that *Indian*

Territory Oil Co. v. *Board* requires that a tax on this income, paid after the State had parted with all interest in the oil, be sustained as one unrelated to the leasing transaction of the State.

4. It is clear that Wyoming Associated was not a state instrumentality and did not derive its income from a transaction with the State. Certainly it cannot be said, to justify this extension of the tax exempt group by the court below, that it has affimatively been shown that the taxation of Wyoming Associated so threatens the independence of the State as to endanger our dual system. But, unless this danger be shown, the special advantage of tax immunity will not be conferred on the private entrepreneur. *Helvering* v. *Powers,* 293 U. S. 214, 224–225; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523; *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, 328; *Willcuts* v. *Bunn,* 282 U. S. 216, 225; *Educational Films Corp.* v. *Ward,* 282 U. S. 379, 391; *National Bank* v. *Commonwealth,* 9 Wall. 353, 362. Correlatively, this Court has been aware of the imperative importance that there be no attrition of the sources of tax revenues. *Willcuts* v. *Bunn,* 282 U. S. 216, 225; *Helvering* v. *Powers,* 293 U. S. 214, 225; *United States* v. *California,* 297 U. S. 175, 184–185; *Susquehanna Co.* v. *State Tax Commission* (*No. 1*), 283 U. S. 291, 294.

Since the rule of the *Gillespie* and *Coronado* cases is not to be applied except in closely analogous circumstances (*supra,* p 14), it seems quite plain that it should not be applied in a case such

as this, where Wyoming Associated was not the lessee of the State lands, had no relation, contractual or otherwise, with the State, and derived its income from the oil development only by virtue of its private arrangement with the lessee.

B. *The Lessee of Government Lands is not Exempt from Taxation on the Income Derived from Them*

It has been shown that the rule of *Gillespie* v. *Oklahoma,* 257 U. S. 501, and *Burnet* v. *Coronado Oil & Gas Co.,* 285 U. S. 393, is not applicable to the facts of this case. It is, therefore, unnecessary to consider whether these cases can be reconciled with subsequent decisions of this Court. If, however, the Court should view the decisions in the *Gillespie* and *Coronado* cases as applicable to the circumstances of this case, it will then be necessary to consider whether or not those decisions are controlling authorities at this time.[3]

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[3] The petition for certiorari (pp. 8–9) in this case, so far as the tax immunity question is concerned, was based upon the propositions (1) that the court below had improperly extended the *Coronado* case, and (2) that there was a substantial conflict with *Bankline Oil Co.* v. *Commissioner*, 90 F. (2d) 899 (C. C. A. 9th), certiorari granted, No. 388, this Term. The memorandum for the Commissioner, not opposing the petition in the *Bankline* case, stated the Government's view that *Burnet* v. *A. T. Jergins Trust*, 288 U. S. 508, was in substantial conflict with the *Gillespie* and *Coronado* cases. There seems, therefore, to be no question but that this question is properly presented to the Court. Compare *Morehead* v. *New York ex rel. Tipaldo*, 298 U. S. 587 604–605.

Since their decision the law of intergovernmental tax immunity has received a considerable development in the decisions of this Court. This development seems to be inconsistent with the result reached in the *Gillespie* and *Coronado* cases, and it is believed that this Court would clarify rather than unsettle the law if at this time it were to reexamine those decisions. The Government accordingly submits: (1) the rule attributed to the *Gillespie* and *Coronado* cases has not been fully accepted by this Court; (2) the postulates upon which those cases rest have since explicitly been rejected by the Court; and (3) the reasons for conferring tax immunity on private persons are absent in the case of a lessee of government lands.

1. This Court has never fully accepted the general rule of the *Gillespie* and *Coronado* cases. This conclusion follows from the course of the decisions relating to the taxation of the income realized from the exploitation of land leased from the government.

The first of the decisions in this field was the *Gillespie* case, decided in 1922. There the State of Oklahoma sought to impose an income tax on the proceeds derived from the operation of an oil lease made by the United States with respect to Indian lands. The parties agreed that the lessee was an instrumentality of the United States (257 U. S. at 504). The Court held that the tax was not saved because it was a net rather than a gross income tax. Then, in 1931, this Court decided *Group No. 1 Oil*

Corp. v. *Bass,* 283 U. S. 279. In that case the Federal Government was held to have constitutional power to tax the net income realized from operations under an oil lease of school lands owned by the State of Texas. The *Coronado* case was decided a year later. There the Federal Government was held unable to tax the income realized from the exploitation of an oil lease of school lands owned by Oklahoma. Finally, in *Burnet* v. *A. T. Jergins Trust,* 288 U. S. 508, the income derived from operations under an oil lease of lands purchased by the city of Long Beach, California, for the purposes of water supply, was in 1933 held subject to federal taxation.

It is difficult to find a consistent course of decision running through these cases. The *Gillespie* and *Coronado* cases seem to be basically indistinguishable from the *Group No. 1* and *Jergins* cases. The ground advanced in the *Group No. 1* case was that, under Texas law, the "grant and lease" was a present sale of the underground oil.[4] In the *Jergins* case, the ground of distinction was that the state lands were not held in trust. Neither distinction seems relevant to the reasons for the rule of intergovernmental tax immunity.[5]

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[4] We have found no evidence that the Texas rule is applied in Wyoming. See Thornton, *Oil and Gas.* Sec. 55 (d) (4th Ed.): *Miller* v. *Buck Creek Oil Co.*, 38 Wyo. 505.

[5] Each distinction, it must be confessed, was urged on this Court by the Government. The Court will note that we do not argue that the *Group No. 1* and *Jergins* cases were wrongly decided, but merely that the acceptance by this

Whether or not an oil lease under state law is technically to be described as a lease or as a sale of the underground oil does not seem sufficient to control the constitutional power to tax the income realized from the lease. Indeed, as a matter of statutory construction, it would be insufficient to control even the application of the Revenue Acts. *Palmer* v. *Bender,* 287 U. S. 551, 555, 556. The reason for the immunity from taxation of income derived from state leases may be viewed as a fear that the State will receive less money for its lease, or as a fear that its freedom to lease will be subject to "interference" if the lessee is taxable. In either case, the taxing power of the Federal Government is just as effective a discouragement to state leases whether they be viewed as a sale of the underground oil or as a privilege to extract it. Accordingly, since "no case has extended * * * immunity to property, real or personal, or income derived from its sale, where it has passed to the buyer by a completely executed act of sale" (*Group No. 1 Oil Corp.* v. *Bass, supra,* 283–284), the two cases extending a similar immunity to the income derived from operations under an oil lease seem incompatible with the *Group No. 1* case. It should be noted that, even where the lease does not effect a present conveyance of the oil in place, the lessee after extracting the oil sells it as his own property.

Court of distinctions which do not go to the heart of the *Gillespie* and *Coronado* rule indicates that this rule is not firmly established.

The *Jergins* case put aside the *Gillespie* and *Coronado* cases on the ground that "in both of those cases the sovereign was acting as the trustee of an express trust with regard to the lands leased" (288 U. S. at 516). But the doctrine of intergovernmental tax immunity rests on the principle that the implications of the Constitution forbid a tax on *any* essential governmental function which threatens the independence of the state or federal government. There seems to be no reason to distinguish lands held in trust for a specific governmental function and those held for governmental functions in general.[6] If the tax on the income of the lessee interferes with a governmental function, it does so as fully in the one case as in the other. In the case of a tax on the income derived from operations under leases from the sovereign of lands held for governmental purposes in general, "its collection is not inconsistent with and does not trench upon the immunity of the state as a sovereign" (288 U. S.

[6] It may be noted that the "trust" which attaches to school lands held by the State is almost indistinguishable from the more or less fiduciary capacity in which all public property is held. In *Cooper* v. *Roberts*, 18 How. 173, the Court said of school land grants (pp. 181–182):

"The trusts created by these compacts relate to a subject certainly of universal interest, but of municipal concern, *over which the power of the State is plenary and exclusive.* In the present instance, the grant is to the State directly *without limitation of its power*, though there is a sacred obligation imposed on its public faith. We think it was competent to Michigan to sell the school reservations without the consent of congress." [Italics added.]

at 516). No more does it trench on a sovereign immunity when the lands are held for a specific governmental purpose.

The *Group No. 1* and *Jergins* cases, while distinguishable in this manner from the *Gillespie* and *Coronado* cases, seem by implication to have disapproved the basic premises of the latter cases. It has been noted (*supra*, p. 14) that the *Gillespie* and *Coronado* cases were decided by a divided Court and have been limited by the Court to closely analogous circumstances. On the other hand, the *Group No. 1* and *Jergins* cases were decided by a unanimous Court, and subsequent opinions have never indicated that their authority is weak.

The decision of the Circuit Court of Appeals for the Eighth Circuit that a lessee of government mining land is taxable on the income which is paid him by his sublessee has been discussed above (*supra*, p. 22). *Wanless Iron Co.* v. *Commissioner*, 75 F. (2d) 779, certiorari denied, 295 U. S. 765. Similarly, the uniform course of decisions in the lower courts is to the effect that a lessee of state lands who erects a building and leases office space is subject to federal taxation on the income so realized. *Eckstein* v. *United States*, 10 F. Supp. 231 (C. Cls.), certiorari denied, 296 U. S. 582; *Metropolitan Building Co.* v. *United States*, 12 F. Supp. 537 (C. Cls.), certiorari denied, 297 U. S. 713; *Helvering* v. *Atlas Life Ins. Co.*, 78 F. (2d) 166 (C. C. A. 10th). It is difficult to distinguish the income which a lessee derives by subleasing and

that which he derives by selling the oil or minerals extracted. If anything, the former would seem to have the more impressive claim for immunity under *Group No. 1 Oil Corp.* v. *Bass, supra.* It hardly seems that the lower courts would have reached these results, or that this Court would have denied certiorari, if the *Gillespie* and *Coronado* rule has the vitality for which respondents contend.

It is respectfully submitted that, if the *Gillespie* and *Coronado* cases were expressly overruled, the administration of the revenue laws both of the Nation and of the States would be simplified, and that the burden of taxes as between persons similarly situated would become both more uniform and more just.

2. This Court has expressly rejected each of the premises advanced in the *Gillespie* and *Coronado* cases to justify the grant of tax immunity to the private operator of an oil lease of government lands.

a. In the *Gillespie* case the Court refused to accept the contention that a net income tax on the lessee produced but a slight or problematic effect upon the lessor State. It put aside the interstate commerce cases [7] on the ground that "the rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in

[7] *Peck & Co.* v. *Lowe*, 247 U. S. 165, 175; *U. S. Glue Co.* v. *Oak Creek*, 247 U. S. 321; *Shaffer* v. *Carter*, 252 U. S. 37, 57.

substance" (257 U. S. at 505). But, in *James* v. *Dravo Contracting Co.*, No. 3, October Term, 1937 (pamph. p. 17), this Court has not only rejected but has reversed this rule, and has held that a gross income tax upon the receipts of a government contractor is valid even though such a tax upon receipts derived in interstate commerce would be invalid.

b. The main ground of the decision in the *Gillespie* case was that "a tax upon such profits is a direct hamper upon the efforts of the United States to make the best terms it can for its wards" (257 U. S. at 506). But obviously the taxation would not force the government to accept an offer to lease the lands which would be less attractive than otherwise would be the case except so far as it operated to reduce the amount of the royalty offered. The effect of taxing the lessee was, accordingly, supposed to be reflected in the *price* received by, as opposed to *interference* with, the sovereign. This ground for conferring tax immunity has frequently been rejected in subsequent decisions of this Court. If a net income tax on the lessee lowers the price received by the government, so too it increases the cost to the government when imposed on its contractors. But such a tax is valid. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *General Construction Co.* v. *Fisher*, 295 U. S. 715. A tax on the sale of goods to the government contractor is valid, even though it must operate to increase the cost of the sovereign. *Trinityfarm Co.* v. *Grosjean*, 291 U. S. 466; *Tirrell*

v. *Johnston*, 293 U. S. 533, cf. *Henneford* v. *Silas Mason Co.*, 300 U. S. 577. A tax on the manufacture or transportation increases the cost to the purchasing sovereign, but is nonetheless valid. *Wheeler Lumber Co.* v. *United States*, 281 U. S. 572; *Liggett & Myers Co.* v. *United States*, 299 U. S. 383. Even more certainly is the cost to the sovereign increased by a gross receipts tax on the contractor's income. Yet such taxes are valid. *Alward* v. *Johnson*, 282 U. S. 509; *James* v. *Dravo Contracting Co.*, *supra*. In the latter case the Court expressly recognized (pamph. pp. 18–19) the probability of added cost to the Government. Finally, the language of this Court in the *Group No. 1* case is fully as applicable to this lease as to that which technically was a "sale" of the oil in place. The Court there said (p. 282):

> We may assume that if the property is subject to tax after sale, the governmental seller will generally receive a less favorable price than if it were known in advance that the property in the hands of later owners, or even of the buyer alone, could not be taxed.
>
> But the remote and indirect effects upon the one government of such a non-discriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense of the taxing power of the other. * * *

c. In the *Coronado* case, while relying chiefly upon the *Gillespie* case, the Court advanced another

reason for the immunity. It said (285 U. S. at 400–401):

> Here the lease to the respondent was an instrumentality of the State for the purpose of carrying out her duty in respect of public schools. To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself.

But since that decision this Court has expressly disapproved the proposition that a tax on the income is a tax on the source. In *New York ex rel. Cohn* v. *Graves,* 300 U. S. 308, the Court sustained a New York tax on the income derived by its resident from New Jersey real estate. This was because "income is not necessarily clothed with the tax immunity enjoyed by its source" (p. 313). And in *James* v. *Dravo Contracting Co., supra,* the Court sustained a tax on the *gross* income of a government contract, expressly stating (pamph. p. 10) that "the tax is not laid upon the contract of the Government."

d. Although not explicitly advanced, it might be thought that the *Gillespie* and *Coronado* cases rest on a general principle that income derived by virtue of a government license, or from government property, is exempt, irrespective of any actual cost or ascertainable interference with the government. *Fox Film Corp.* v. *Doyal,* 286 U. S. 123, sustaining a state tax on income realized under a copyright, is a sufficient answer to the first suggestion. And since the oil, from the moment it is extracted, is no

longer the property of the State, this case differs in no manner from the usual case of resale of property purchased from the government. Income derived on such a resale, of course, is not tax exempt. *Group No. 1 Oil Corp.* v. *Bass, supra,* 282.

No other reason advanced by the Court as the ground for the decisions in the *Gillespie* and *Coronado* cases has been discovered. Each of the premises relied on in those cases has expressly been rejected by subsequent decisions of this Court.

Moreover, the rule of the *Gillespie* and *Coronado* cases seems directly contrary to the decision in *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325. There this Court sustained an *ad valorem* tax on oil, extracted under a lease of Indian lands, which was stored after payment of the agreed royalties. It said (p. 328):

> Such immunity as petitioner enjoyed as a governmental instrumentality inhered in its operations as such, and being for the protection of the Government in its function extended no farther than was necessary for that purpose. **The holding of the oil in question, which had been segregated and withdrawn from the restricted lands as petitioner's exclusive property, awaiting disposition at petitioner's pleasure, was for its sole advantage and cannot be said to be so identified with its operations as a governmental instrumentality as to entitle it to exemption from the general property taxes imposed by the State in return for the protection the State afforded.** * * *

At least where, as in this case, the royalties are paid in kind, a precisely comparable situation is present in the case of the income tax. The lessee first extracts the oil. At the mouth of the well he delivers the oil to the lessor. The remaining oil is his absolute property. Under the *Indian Territory* case, he is subject to a property tax on this oil. No reason is apparent why he should not also be subject to an income tax.[8]

If there were any doubt that this rule is equally applicable to an income as to a property tax, it would be removed by the decision of this Court in *Peck & Co.* v. *Lowe,* 247 U. S. 165. There the express constitutional prohibition against a tax "on articles exported from any State" (Art. I, Sec. 9, cl. 5) was held inapplicable to a tax on the income derived from export sales.[9] This Court said (pp. 174–175) of the income tax there in question:

> It is not laid on income from exportation because of its source, or in a discriminative way, but just as it is laid on other income. The words of the act are "net income arising or accruing from all sources." There is no

[8] It is true that the deductions from gross income reach back into the period prior to the payment of the royalty. But it is not the deductions, allowed as a matter of grace, but the income which is taxed; this is realized only after payment of the royalties.

[9] The decision in *Liggett & Myers Co.* v. *United States,* 299 U. S. 383, relying on *Cornell* v. *Coyne,* 192 U. S. 418, shows that taxation permitted under clause 5 of Section 9 of Article I is equally permitted under the implied prohibition against intergovernmental taxation.

> discrimination. At most, exportation is affected only indirectly and remotely. The tax is levied after exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses. * * *

3. It is unnecessary to dwell upon the fact that maintenance of tax revenues is a matter of imperative importance both to the States and the Nation (*supra*, p. 24). Similarly, it is unnecessary to elaborate the unfortunate consequences which flow from a division of private competitors into taxable and tax-exempt classes; there inevitably develop conditions of special advantage, dissatisfaction, and general lack of confidence in the equity of taxing systems. It is for these reasons that this Court has so often announced that it would hold unconstitutional only those taxes which contain a real and substantial threat to the maintenance of that independence of the States or the Nation which is essential to our dual system of government.[10]

The power to tax the income realized by the lessee of government lands in no sense contains a threat to this necessary independence of the nation and the states. The government lessor remains

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[10] *Helvering* v. *Powers*, 293 U. S. 214, 225; *South Carolina* v. *United States*, 199 U. S. 437; *Ohio* v. *Helvering*, 292 U. S. 360, 368–369; *Board of Trustees* v. *United States*, 289 U. S. 48, 59; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523; *Indian Territory Oil Co.* v. *Board*, 288 U. S. 325, 328; *Willcuts* v. *Bunn*, 282 U. S. 216, 225; *Educational Films Corp.* v. *Ward*, 282 U. S. 379, 391; *National Bank* v. *Commonwealth*, 9 Wall. 353, 362.

wholly free to lease or not, as it chooses. It may prescribe the terms of the lease with the same freedom which it otherwise would have. It may, as fully as though the lessee were tax exempt, use the proceeds for whatever purpose it desires.

The only possible effect upon the government lessor is that the sovereign would lose an advantage now possessed, in that oil and mineral operators would no longer be more anxious to lease from the government than from a private lessor. This is a very doubtful conclusion. The overwhelming consideration in such leases, typically, may be supposd to be the gamble as to the quantity and ease of extraction of the oil or mineral which is in place underground. If the development is successful, the profits usually will be larger than in the ordinary business enterprise. It seems most unlikely that the typical lessee would substantially reduce the terms he offers the government lessor if he knew that his net income would be subject to taxation. His decisions are shaped by geologic rather than cost accounting estimates.

But even if it be assumed that occasionally or even generally the government lessor would receive a somewhat larger royalty if the lessee were exempt from an income tax on his profits from the lease, this in no sense invalidates the tax. The independence of the government does not require that it receive a *special* advantage in the market place. A non-discriminatory tax upon the income of lessees of mineral lands, even though it were to reduce

somewhat the revenues of the government lessors, is wholly irrelevant to the governmental functions either of the States or the Nation. If this Court were so to hold, it is submitted that its decisions would be made more consistent, that the doctrine of intergovernmental tax immunity would be brought more nearly into line with its reasons, that the revenues of the central and the local governments would be augmented, and that the undesirable and special privilege of tax immunity now extended to certain of the competing oil and mineral operators would be eliminated.

II

THE CASH PAYMENTS RECEIVED BY RESPONDENT'S AFFILIATE FOR OIL AND GAS PRODUCED CONSTITUTE THE "GROSS INCOME FROM THE PROPERTY" ON WHICH ITS PERCENTAGE DEPLETION SHOULD BE COMPUTED

In the present case Wyoming Associated, the respondent's affiliate, has been allowed a depletion allowance on its gross income received from the property in the form of the cash payments received for oil sold to the Refining Company. The question for determination is whether computation of Wyoming Associated's gross income from the property for depletion should also include the amount of the development and production expenses paid by the Refining Company.

Section 234 (a) (8), Revenue Act of 1926 (Appendix, p. 57), provides that in computing net income corporations may deduct a reasonable allowance for depletion of oil and gas wells. Section

204 (c) (2) (Appendix, p. 56), provides that this allowance shall be "27½ per centum of the gross income from the property" during the taxable year, provided (1) that the allowance shall not exceed "50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property", and (2) that the allowance shall not be less than it would be if computed without reference to this paragraph.

The Commissioner of Internal Revenue and the Board of Tax Appeals treated the total cash payments of $4,606,535.70 paid to the seller of the oil, Wyoming Associated, by the purchaser, the Refining Company, as the "gross income from the property" of Wyoming Associated for the computation of its 27½% depletion allowance (R. 41).

The respondent contended before the Board of Tax Appeals that the gross income for percentage depletion should be considered to be the market value of the oil or, in the alternative, the sum of the aforesaid cash payments plus the field operating expenses of the Refining Company stipulated to be $2,816,520.04 (R. 38, 145). In the court below the respondent elected to rely upon the second alternative and the court allowed percentage depletion on this basis (R. 153–155). Before the Board the respondent also relied on depletion based on cost in lieu of percentage depletion (R. 22, 32, 45) and since the Board reduced the deficiency to some extent the respondent evidently was allowed cost depletion where it exceeded percentage depletion com-

puted without reference to the Refining Company's production expenses.

The Government contends that the cash price received for oil is the seller's entire "gross income from the property" for percentage depletion where, as here, the oil is produced and purchased under contracts whereby the purchaser, the Refining Company, agrees to conduct and to pay the expense of development and production operations and to pay a cash price for all oil produced which is based on prices it obtains for gasoline and kerosene sold at its refinery. The Government contends that under this contractual arrangement (A) the Refining Company's production operations are not gross income of Wyoming Associated; (B) even if any value of the operations to Wyoming Associated is its gross income, the actual expenses of the Refining Company is not the measure of that value to Wyoming Associated; and (C) the respondent's contention denies the Refining Company any depletable interest in the oil.

A. *The Refining Company's production operations are not gross income of Wyoming Associated*

1. The Government contends that the production operations performed by the Refining Company for its own benefit are not gross income of Wyoming Associated. There may be some circumstances in which services rendered on behalf of and for the separate use of a taxpayer may be considered to

have a value to him which can be expressed in terms of money and which can be considered to increase his gross income at the time he receives the services. For example, one who pays cash for a physician's services does not realize income from the transaction, but one who exchanges a share of stock for such services may realize income based on the difference between the cost or other basis of the stock and the value of the services to him, which might be the market price of the stock. In other circumstances, however, one may receive something of value in the form of property which, under one view at least, might be considered to be income at the time some disposition of it is made, but not at the time it is received. An illustration is the question whether a lessor receives income when a lessee places a building on the real estate or not until the property is sold or the lease expires. Cf. *Hewitt* v. *Commissioner,* 76 F. (2d) 880 (C. C. A. 2d, Chase, J.; L. Hand, and Swan, J. J., concurring in a separate opinion). It is submitted, however, that where, as in the present case, oil production operations are conducted by a purchaser ***for his own benefit*** in order to obtain the oil at a contract price which he may deem favorable, those operations are not income of the seller of the oil. They are not "something of exchangeable value * * * ***received*** or ***drawn by*** the recipient (the taxpayer) for his ***separate*** use, benefit, and disposal—***that*** is income derived from property." (Italics by the Court.) *Eisner* v. *Macomber,* 252 U. S. 189, 207.

Wyoming Associated evidently accepted this view because it did not include the production expenses in its gross income on its books or in the income tax return (R. 37).

2. The respondent argued in its brief in the court below that the Refining Company paid something in addition to the cash price for the oil because the cash contract prices were less than the market price happened to be when the oil was produced. This argument does not support the respondent's contention, even if there was a difference between market and contract price in a particular year, because when the contracts were made for a period of approximately eleven years from February 1, 1923, to January 1, 1934, the parties could not determine a contract price based on possible future market prices and production expenses. They could not have intended that the Refining Company should pay something for the oil in addition to the cash price on the basis of unknown future market prices and production expenses.

Moreover, the contract price was expressly related to a basis other than market price and might be greater than market price. The assumption that there would necessarily be a difference between market and contract price of the oil under these contracts is erroneous. The method of determining the cash purchase price for oil provided in the contracts does not refer and is not related to the field market price of oil. The contract price is not fixed at less than market price so

that it may be said that Wyoming Associated was being paid cash and services equal to the market price.

The cash contract price was based on a sliding scale depending on the current monthly price obtained by the Refining Company for gasoline and kerosene sold from its refinery at Casper, Wyoming (R. 114). This scale of cash prices did not insure that the Refining Company would always pay less than market price for the oil. There is no fixed margin between the prices of crude oil and gasoline and kerosene.[11] Situations might have arisen in which the Refining Company would have paid in cash more than the market price of the oil. Both parties gambled on the future relation between the market prices of oil and those of gasoline and kerosene.

The Refining Company was obliged to conduct the production operations under the contracts. Wyoming Associated also assumed obligations under the contracts. The Refining Company had the right to use, free of charge, all of the storage facilities, building equipment, and pipe lines of Wyo-

[11] There have been periods when the price of crude oil dropped to a few cents a barrel and the average price of gasoline dropped only a few cents a gallon. For example, when the price of crude oil fell to extremely low levels between January and August 1931, the average retail price of gasoline to the consumer dropped only 2.35 cents; the drop in retail prices during the collapse of crude oil prices in 1933 was only 1.72 cents. See Oil and Gas Journal, January 25, 1934, p. 42.

ming Associated on the property (R. 114–115). The Refining Company was entitled to use, free of charge, so much of the oil and gas produced as was reasonably necessary for drilling, domestic service, and production (R. 115). These factors must have been considered in fixing the cash price paid for the oil. It is impossible as a practical matter to construct a theoretical price which would give effect to all of the factors which probably influenced the parties in fixing the contract price. In these circumstances a "gross income" for depletion should not be constructed artificially by adding some amount to the cash contract price received as gross income.

The production operations were promised and rendered by the Refining Company, not as part of the purchase price of the oil, but for its own benefit and in consideration for the promise of Wyoming Associated to permit the Refining Company to produce the oil and to purchase it at a price which bore a relation to the purchaser's gasoline and kerosene prices. This is made apparent by the fact that if drilling had been unsuccessful and if no oil had been produced the services could not have been considered as part of the purchase price for oil, but would be paid for by the promise to sell oil produced at a fixed price. This is the meaning of the contracts as performed by the parties even though they recite that "as part of the price of oil purchased" (R. 115, 120) the production opera-

tions are to be conducted by the Refining Company. These recitals alone cannot make the production operations Wyoming Associated's gross income if in fact they were performed for the Refining Company's benefit and not for Wyoming Associated's "*separate* use, benefit, and disposal, * * *." *Eisner* v. *Macomber, supra.*

3. The court below relied on the consideration it expressed to the effect that if Wyoming Associated had produced the oil at its own expense its gross income would have been the price of the oil, including in cash the amount representing the cost of production, and, therefore, the same result should be reached where the purchaser produces the oil (R. 154). The premise is not correct because it could not be certain that either a market or a contract price for oil produced by the seller would even repay operation expenses. Perhaps the avoidance of that risk and speculation is the reason the seller entered this contract.

Moreover, there is no weight, for tax purposes, in the argument that the same result should be reached as if Wyoming Associated had engaged in the business of producing oil. Wyoming Associated chose not to engage in the oil producing business and preferred the business of allowing the purchaser to engage in the risks of production. The different types of business produce different gross incomes from the property. This is true generally of any taxpayer who owns raw material

and chooses to permit a purchaser to prepare it for the market rather than to engage in that business himself. The seller cannot artificially construct his gross income as if he had engaged in the purchaser's business. "To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty." *Founders General* v. *Hoey,* 300 U. S. 268, 275.

The sole authority cited by the court below on this point, *Boulton* v. *Heiner,* 3 F. Supp. 372 (W. D. Pa.), is distinguishable, we believe. The court held that the cost basis of stock included not only the cash paid but also services as incorporator rendered for the stock. That decision does not support the view that oil production operations by a purchaser rendered for his own benefit are gross income of the seller for his separate use.

An owner of oil, or any other commodity, instead of preparing the product for delivery and sale, may prefer to charge a lower cash price and to permit the purchaser to undertake the work and expense of preparing the product and making delivery. It would not be said that the seller's price is the cash price plus the value of the services to him. The common, and correct, view is that the seller has lessened his work, lowered his price, and decreased his gross income. The purchaser's processing operations are work for his own benefit, and not work

which is a source of income to the seller in a sum greater than the cash price. The services are not a part of the sale price. The contrary view that the services are part of the sale price and, in effect, that the price has not been reduced, is at a variance with the common understanding that the price is lowered and is an artificial and impractical view of gross income.

4. The arguments stated *supra* in support of the contention that the production operations are not gross income of Wyoming Associated also support the view that these operations are not its "gross income from the property" within the meaning of Section 204 (c) (2) of the Revenue Act of 1926. Cf. *Crews* v. *Commissioner,* 89 F. (2d) 412 (C. C. A. 10th).

This Court has also held that the phrase "gross income from the property" means gross income from the oil and gas[12] *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 321. See also *Brea Cannon Oil Co.* v. *Commissioner,* 77 F. (2d) 67 (C. C. A. 9th), certiorari denied, 296 U. S. 604; *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. (2d) 161 (C. C. A. 2d), certiorari denied, 296 U. S. 634; *Greensboro Gas Co.* v. *Commissioner,* 79 F. (2d) 701 (C. C. A. 3d), certiorari denied, 296 U. S. 639;

[12] Bonuses are regarded as income from oil and gas in the form of advanced royalties. *Herring* v. *Commissioner,* 293 U. S. 322. The allowance of depletion with respect to such payments is based on that theory.

Article 221, Regulations 69, *infra*. It does not even include cash payments received from the sale of leases of oil properties. *Darby-Lynde Co.* v. *Alexander,* 51 F. (2d) 56 (C. C. A. 10th), certiorari denied, 284 U. S. 666; *Commissioner* v. *Fleming,* 82 F. (2d) 328 (C. C. A. 5th).

In *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, the Court rejected a sublessee's contention that all the gross income which it actually received, and reported in its return as such, was its "gross income from the property" to the extent of royalties it was obliged to and did pay over to its lessor. The Court stated (at page 321):

> We think Congress did not intend a different result where, as here, the lessee sells all the oil and pays over the royalty in the form of cash.

It is submitted that in a case like the present, Congress did not intend that in addition to the contract price some value to the seller, to be placed on production operations by a purchaser, should be included in the seller's gross income from the property. The statute does not require and it was not intended that gross income from the property should be computed in this manner.

The percentage depletion deduction is an arbitrary amount allowed as a matter of grace in place of cost depletion at the taxpayers' option. To succeed the taxpayer must bring his case clearly within the statute. The doubts in this case must be resolved against the taxpayer.

5. The fact that the production operations, performed by the Refining Company for its own benefit, may have been some benefit to Wyoming Associated does not make the operations additional gross income from the property of Wyoming Associated. The extent of the benefit is the cash price received for the oil. The production operations of a lessee are a benefit to the lessor to the extent of the royalties paid in cash or oil in such a case as *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312. But it is not supposed that the lessor could claim the lessee's production operations as depletable gross income in addition to royalties.

The fact that the purchaser under a contract may have no depletable interest is no reason to increase the gross income actually received by the seller by the production expenses of the purchaser.

6. Finally, the Court answered the contention that the statute may work unequal results when it concluded its opinion in the *Twin Bell* case with the following statement (p. 321):

> The respondent insists that, so applied, the section may work unjust and unequal results, but it is to be remarked that this is likely to be wherever a rule of thumb is applied without a detailed examination of the facts affecting each taxpayer. No doubt, as the petitioner points out, equally illogical results might ensue from the application of the statute as the respondent construes it. And it is also to be remembered that depletion upon cost on March 1,

1913, value is optional with the taxpayer, if that procedure is more favorable to him.

It is submitted that in the present case the statute should not be construed to give the seller of oil in the circumstances of this case a gross income in addition to the cash price received for the oil by placing a value to the seller on the production operations of the purchaser. Depletion should be based on the cash price for the oil, or cost or March 1, 1913 value, at the taxpayer's option.

B. *Even if some value of the production operations to Wyoming Associated is included in its gross income, the total production expenses are not the correct measure of that value*

The field operating expenses in the sum of $2,816,520.04 (R. 145) do not supply a correct measure of any value the production operations may have to Wyoming Associated. It does not appear that all of the production operations contributed to the oil produced and sold. A large part of the operations and a large part of the expenses may have been used on dry wells producing no oil and may have been of no value to anyone. The less expensive operations may have produced and may measure the value of all of the oil.

Furthermore, under the contracts the operations were conducted for the benefit of the Refining Company as well as for the benefit of Wyoming Associated. The entire expenditures cannot be taken as the measure of the value of the production opera-

tions to Wyoming Associated without allocation of part of the expenditures to the value of the production operations to the Refining Company which may have obtained oil at a very favorable price.

These considerations disclose the difficulty of attempting to create a theoretical gross income from the property by the evaluation of production operations. It is submitted that the statute was not intended and should not be construed to cover such a situation. In this situation, the depletion allowance of Wyoming Associated must be based either on the cash price received for the oil or on cost of the oil property. *Helvering* v. *Twin Bell Syndicate, supra.*

C. *The Respondent's Contention Leaves No Depletable Interest to the Refining Company*

The Government contends that the "gross income from the property" does not include the value of the production operations and does not contend that the Refining Company has a depletable interest in the oil represented by production expenses or any other sum. It may be noted, however, that the acceptance of the respondent's contention would bar the purchaser from a depletable interest.

It is the Government's basic contention expressed in the three cases to be argued immediately before this case [18] that only owners of oil and gas, *as pro-*

[18] No. 387 (*Helvering* v. *Bankline Oil Co.*); No. 406 (*Helvering* v. *O'Donnell*); No. 446 (*Helvering* v. *Elbe Oil Land Development Co.*).

duced, have such an ownership of, or interest in, the mineral in place as to entitle them to depletion. Cf. Government's brief, p. 7, in No. 387 (*Helvering* v. *Bankline Oil Co.*).

A purchaser of oil or gas under a contractual arrangement, unlike a lessee, has no such ownership or interest and, therefore, is not entitled to depletion. In *Signal Gasoline Corp.* v. *Commissioner,* 66 F. (2d) 886 (C. C. A. 9th) however, the Court held that the purchaser of wet gas, under a contract for which a valuable consideration was paid and in which the purchaser agreed to assist, and thereafter did assist, in the production of wet gas by installation and operation of machinery for that purpose at great expense, did have a right to share in the wet gas produced and a depletable interest which might be proved. On a second appeal, 77 F. (2d) 728, certiorari denied, 296 U. S. 657, the Court stated that the difference between the market value and contract price of wet gas was the purchaser's depletable interest and that the purchaser had failed to prove any such difference.

The Government believes that the theory of the Court's decision in the *Signal* case that market price of oil may determine gross income from oil or gas sold at a contract price is erroneous and is clearly a misapplication of the principles announced by this Court. *Palmer* v. *Bender,* 287 U. S. 555, and *Helvering* v. *Twin Bell Oil Syndi-*

cate, 293 U. S. 312. The market price of the oil in the present case, which was not in fact received for the oil, could not be considered, as the respondent has contended, as a basis for depletion of the Refining Company. Its only possible basis for depletion, if any, would be a part of the oil considered to be obtained in exchange for the production operations.

Apart, however, from the erroneous views, we believe, with respect to the application of market price expressed by the court in the *Signal* case, the first opinion does recognize that a contract whereby a purchaser of gas obtains the right to occupy the land and to conduct production operations, and who pays the producing expenses, may obtain a depletable interest as well as the lessee and seller of the oil.

The Government does not contend that such a contract, distinguished from the contracts involved in No. 387, October Term, 1937 (*Helvering* v. *Bankline Oil Co.*), at page 11 of the Government's brief in that case, may in some cases give the purchaser a depletable interest in oil as produced, whether he sells it at a market or contract price. But if the Court thinks such a "purchaser-producer" contract might give the purchaser a depletable interest it is to be noted that the respondent's contention would deprive the purchaser of any depletable interest.

CONCLUSION

It is submitted that the judgment of the Circuit Court of Appeals is erroneous and should be reversed upon both of the issues presented.

Respectfully submitted.

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JANUARY 1938.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political sub-

division thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

* * * * *

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

> ART. 217. *Depletion and depreciation accounts on books.*—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be charged the cost or the fair market value as of the basic date, as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account.
>
> When the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it can not be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation sustained; or the amounts of the depletion and depreciation sustained shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed. See, however, section 204 (c) (2) and article 221 as to oil and gas wells.
>
> ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property.

In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

ART. 223. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under the provisions of this article will control the taxpayer's returns for all subsequent years. Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice

has been carried should accompany the return.

ART. 225. *Depreciation of improvements in the case of oil and gas wells.*—Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 223. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation on such property may be based upon the length of life of the deposit. (See articles 161–170.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 600.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

MOUNTAIN PRODUCERS CORPORATION.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinions Below.

The majority and dissenting opinions of the Circuit Court of Appeals for the Tenth Circuit (R., 199) are reported in 92 F. (2d) 78.

Jurisdiction.

Jurisdiction of this Court to entertain petition for certiorari is correctly noted in the petition.

Questions Presented.

1. The interest of respondent's affiliate (The Wyoming Associated Oil Corporation, hereinafter called Wyoming Associated) in an oil and gas lease from the State of

Wyoming, covering school lands, is evidenced by a declaration of trust executed by the lessee named in the lease prior to the issuance of the lease itself. Is income which Wyoming Associated received from this lease exempt from Federal income tax?

2. The purchaser, under written contract with Wyoming Associated, of all the oil produced during specified years from oil lands of Wyoming Associated (not restricted to the State lease noted above), in addition to paying per barrel cash sums, agreed "as part of the price for oil purchased" to perform at its own expense on the lands in question all acts of production and development specified in the contract. Is the *value* of the production and development services so rendered a part of the gross income of Wyoming Associated for the purposes of percentage depletion?[1]

Statutes and Other Authorities Involved.

The statutes and other authorities involved are set forth in the Appendix, pages 14 and 15.

Statement.

Wishing to make our brief as short as possible, we attempt no separate summary of the facts, but refer this Court to the summary set forth in the majority opinion below (R., 200).

---

[1] In the petition the Solicitor General states this question in terms of whether purchaser's expenses are gross income to the taxpayer. In the true sense it is not the purchaser's expenses, as such, which were added to the the taxpayer's gross income; what was really added was *the value of the services*, the stipulated cost of performing the services being used by the lower court merely as the best evidence for measuring the value of the services.

Argument.

The petition for certiorari should be denied, and this Court should not review either of the issues involved.

Issue I.

THE COURT BELOW DID NOT ERR IN HOLDING THAT THE INCOME RECEIVED BY WYOMING ASSOCIATED FROM THE STATE SCHOOL LEASE WAS EXEMPT FROM INCOME TAX; NOR IS ITS DECISION ON THIS POINT IN CONFLICT WITH ANY OTHER DECISION.

The court below held that the principle of *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, rules the present case. From the agreed facts summarized and condensed in the opinion of the court below, it is apparent that in the instant case (a) the character of the land from which the income was obtained, (b) the source of the State's title thereto (a grant from the United States for school purposes made when the State was admitted to the Union), and (c) the nature of the express trust "for the exclusive benefit of the public schools * * * forever inviolate and undiminished",[1] under which the land and all income accruing to the State therefrom are held, are all identical with the corresponding elements in the *Coronado* case. In the *Coronado* case this Court has recognized tax exemption as applying to the income of a corporate lessee recovering oil from such land, the lease being an instrumentality of the State in performing this sovereign trust obligation.

Even though this doctrine be applied "strictly and only in circumstances closely analogous to"[2] those under which the doctrine originated, it was no extension of the doctrine to apply it to this case. The dissenting opinion in the court

[1] Sec. 6, Art. VII, Constitution of the State of Wyoming accepting United States land grant.

[2] *Burnet* v. *A. T. Jergins Trust*, 288 U. S. 508, 516.

below and the petition for certiorari (pet. 8) incorrectly point out an alleged distinction, charging that Wyoming Associated was not a direct lessee from the State, but "had direct contractual relations only with the private lessee of the state lands," thus invoking the rule of cases of the *Wanless* type.[1] The majority opinion of the court below more accurately states:

> "In the case at bar we find the lessee and the taxpayer bound together by a trust agreement entered into before the lease by the state was made by which they were to have equal rights in the lease * * *."

The stipulation of facts (R., 70, Pars. 5(c), 6 and 7, R., 71, Pars. 8 and 11, R., 74, Par. 27, R., 77, Par. 36) in much greater detail shows that the interest of Wyoming Associated in the State lease was not derived from the nominal lessee, Midwest Oil Company, but may be traced back to a segregated fractional interest in the original State lease of 1910, of which the State lease involved herein was the fourth renewal. The declaration of trust executed by Midwest Oil Company on February 1, 1923 (R., 146), upon which petitioner relies in urging a distinction between this and the *Coronado* case, was not the assignment or creation of a subinterest in that lease, but was the explicit recognition of a continuing ownership by Wyoming Associated and its predecessors of an equitable interest in the original lease and in all its renewals and extensions.

It is a common occurrence, as here, for a lease to be taken in the name of the common agent of a partnership or a corporate group. The real and direct character of the title accruing to each beneficiary of such a resulting trust is recognized for all tax purposes. As a matter of fact, any corporation in acquiring a lease would have had to act through others, i. e., through its officers or through other agents.

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[1] *Wanless Iron Co.* v. *Commissioner*, 75 F. (2d) 779 (C. C. A. 8th, 1935), cert. den. 295 U. S. 765, in which tax exemption is denied with respect to income received by the assignee of a lease from its sublessees. This was held too remote from the State.

That Wyoming Associated acted through another corporation as its agent, rather than through its own officers, would be tenuous ground for denying the application of the *Coronado* case. The declaration of trust referred to bears a date earlier than the particular lease involved in this case. From these title facts (peculiar to this case and of little general significance in the development of any rule of law) the lower court finds:

> "* * * In substance and effect the Wyoming Associated was as much a lessee of the lands as was the Midwest Oil Company, the lessee in name."

There is thus no valid ground for denying the applicability of the *Coronado* case. We are here dealing with the status of a true original party to the lease, and it is an immaterial circumstance that such party was represented in the contractual negotiations with the State by a trustee or agent. The revenue acts uniformly look to the substance of the transaction rather than to technical matters of form in determining the identity of the recipient of income or the identity of the person entitled to claim deduction or exemption. Cases of the type of the *Wanless* case, on the other hand, illustrate a different principle.

The position of the taxpayer in the *Wanless* case was that of assignee of a lease from the State of Minnesota originally granted to Wanless individually. The taxpayer, Wanless Iron Company, in turn had subleased to three other parties and received an intermediate royalty, not from the State of Minnesota, but from these sublessees. The opinion of the Eighth Circuit Court of Appeals points out that the operations were not carried on under the State lease, but under subleases between the taxpayer-assignee and its sublessees. The net income of the taxpayer, therefore, arose from operations in a private capacity for private gain. These were held to be too remote to merit tax exemption. In the instant case no such remoteness exists. The Wyoming Associated did pay royalty to the State of Wyoming. It

made delivery to the State of royalty oil in kind. It sold its fraction of the oil remaining direct to The Midwest Refining Company. It collected its part of the proceeds without any intervention of the Midwest Oil Company with respect thereto (R., 78-79). The arrangement between the Midwest Oil Company and Wyoming Associated constituted a dry, passive trust, not an assignment under which the assignee received income from its sublessees. The Midwest Oil Company retained no intermediate royalty, as did the Wanless Iron Company (R., 79).

Petitioner also bases his request for certiorari of the tax exemption question upon an allegation of "substantial conflict"[1] between the decision of the Tenth Circuit Court of Appeals in the instant case, and the decision of the Ninth Circuit Court of Appeals in the *Bankline* case, which latter case follows the decision of this Court in the *Jergins* case. No such conflict exists.

The *Bankline* case turned on the valid distinction, which has for the past five years been recognized by this Court, between (1) income from a State lease covering "school lands" where the land was granted by the United States to the State at the time of its admittance into the Union and the land is held by the State under this express trust for the benefit of common schools (*Burnet* v. *Coronado Oil & Gas Co., supra*), and (2) income from a municipal lease covering land thus in substance owned by the State, *but not*, as far as its oil content or its value is concerned, *devoted to any specific sovereign trust.* (*Burnet* v. *A. T. Jergins Trust, supra*). Even the Commissioner in his memorandum reply to the petition for certiorari in the *Bankline* case says (at p. 2):

> "* * * It is probable that the decision in this case (*Bankline*) can be reconciled with the *Mountain Producers* case on the ground suggested in the *A. T. Jergins* case, where the Court distinguished the *Gillespie* and *Coronado* cases on the ground that the

[1] In his memorandum on petition in *Bankline Oil Co.* v. *Commissioner* (90 F. (2d) 899 (C. C. A. 9th, 1937)), No. 388 in the Supreme Court on certiorari, the Solicitor General used, in addition to the expression "substantial conflict", the expression "apparent conflict" (p. 3).

> government lands were in those cases held pursuant to an express trust (p. 516). In the present case, the lands are tide lands owned by the State of California in its sovereign capacity and its trusteeship is implied rather than expressed. In the *Mountain Producers* case the State of Wyoming leased lands granted by the United States to the State for the maintenance of its schools. It is possible that the title of the State of Wyoming may be more akin to that of an express trustee than is that of the State of California in the present case. But we do not believe that this distinction can properly be given controlling weight; * * *"

But this distinction was given controlling weight by this Court in the *Jergins* case. The point is settled.

Whether the facts in the *Bankline* case classify it with the *Jergins* case or with the *Coronado* case, it seems clear that it can present no conflict with the decision of the instant case in the court below. The decision below turns on a point not involved in the *Bankline* case, i. e., the special situation presented by the status of the Wyoming Associated under the declaration of trust, and this point is of no general significance to taxpayers.

Issue 2.

THE COURT BELOW DID NOT ERR IN HOLDING THAT THE GROSS INCOME OF WYOMING ASSOCIATED, FOR THE COMPUTATION OF PERCENTAGE DEPLETION, SHOULD INCLUDE NOT ONLY THE CASH RECEIVED FOR THE OIL SOLD BUT ALSO THE VALUE OF THE PRODUCTION AND OTHER SERVICES PERFORMED BY THE PURCHASER PURSUANT TO THE PURCHASE AGREEMENT; NOR DOES THE DECISION OF THE COURT BELOW ON THIS POINT CONFLICT WITH ANY OTHER DECISION.

The Solicitor General claims that the decision of the court below on the percentage depletion point is in conflict with the decision in *Signal Gasoline Corp.* v. *Commissioner,* 66 F. (2d) 886 (C. C. A. 9th, 1933), and *Bankline Oil Co.*

v. *Comm., supra.* These cases decided that a purchaser of wet gas might, under certain circumstances, have a depletable interest in part of the mineral produced. This would mean, according to the Solicitor General, that the purchaser in the instant case would be entitled to depletion all of which, according to the Solicitor General, has been allowed to Wyoming Associated.

The petition for certiorari (p. 10) on this point says:

> "* * * the decision of the court below gives the entire allowance to respondent, the vendor, and in effect excludes the purchaser from any possible depletion allowance, and the decision, therefore, presents a conflict in principle with the decisions of the Circuit Court of Appeals for the Ninth Circuit in the *Signal* case *supra*, * * * and in *Bankline Oil Co.* v. *Commissioner*, * * *."

Since no one but the Wyoming Associated owned any interest in the oil (*Thomas* v. *Perkins*, 57 S. Ct. 911), it might well be argued that the "entire allowance" of depletion should be given to respondent,[1] as the Solicitor General says has been done. However, it is unnecessary to discuss this problem because the conflict alleged between the *Signal* and *Bankline* cases on the one hand, and the instant case on the other hand, depends upon the correctness of the Solicitor General's statement that the decision of the court below does give the entire depletion allowance to respondent. If it does not do so, there is admittedly no conflict.

If the entire depletion allowance were given to respondent, the gross income of the respondent for percentage depletion purposes would be the market price of oil times barrels produced. Under the decision of the court below the respondent does not get the benefit of depletion on any such basis. The decision of the court below simply permits

---

[1] The Record shows that title to oil in the instant case passed from Wyoming Associated to The Midwest Refining Company, after it had been severed from the land "at the outlet gates of the measuring tanks located" on the leases (R., 151).

the inclusion in gross income, for percentage depletion purposes, of the cash contract price of oil plus the value of the services rendered pursuant to the contract "as part of the price for oil purchased" (R. 45, 150-1). The total gross income computed under the lower court's decision amounts to $7,423,055.74 (the cash contract price of $4,606,535.70 plus a value of services proved by production cost of $2,816,520.04; R. 189), whereas the total gross income calculated with reference to the market price of oil would be $8,411,450.19 (a production in the year of 4,650,794.50 barrels times the stipulated average field price of $1.808605 per barrel; R. 189, 77). The difference of $988,394.45 is available as a basis for depletion to the purchaser if the purchaser should be held entitled thereto. Therefore, the Solicitor General's contention that this case conflicts with the *Signal* and *Bankline* cases falls,—falls because it is founded on an incorrect understanding of the effect of the lower court's decision.[1]

There is no conflict between the *Signal* and *Bankline* cases on the one hand, and the instant case on the other hand, for the reason that the former two cases, as decided by the Ninth Circuit Court of Appeals, contemplate the calculation of depletion on exactly the same basis as has been sanctioned by the Tenth Circuit Court of Appeals in the instant case (p. 904). The opinion of the court in the

[1] The Solicitor General is, perhaps, misled by the fact that before the Board of Tax Appeals respondent, at that time petitioner, claimed, alternatively, depletion on the market value of the oil. This was done on the theory that the difference between the cash contract price of the oil and the market value of the oil afforded a yardstick to measure the value of the services or, in other words, that the total market price would be one way of showing the total price, i. e., cash plus the value of the services. If the taxpayer had stood upon this position before the Circuit Court of Appeals and had been sustained by that court, there would be some ground for the Solicitor General's statement that the Circuit Court of Appeals decision left no possibility of any depletable interest in the purchaser and was, therefore, in conflict with the *Bankline* and *Signal* cases. But the taxpayer, when it came before the Circuit Court of Appeals, elected to rely upon the cost to the purchaser of performing its services as a sounder measure of value, hence, instead of claiming depletion based on the market price of the oil, the taxpayer asked and was granted depletion only on a lesser sum made up of the contract price of the oil plus the value of the productive services rendered by the purchaser as proved by the stipulated cost thereof.

Bankline case, reiterating its decision in the *Signal* case, states that it there held that, for the purpose of determining the depletion allowance, the gross income from the property of a manufacturer who produced gasoline from wet gas was "the difference between the market value of the wet gas delivered to it less *the amount the manufacturer had agreed to pay for it*" (italics supplied).

The italicized phrase appropriately applies to a payment in services as well as to payments exclusively in cash. From the viewpoint of the seller, the *Signal* case is clearly consistent with an allowance to the seller of percentage depletion based upon gross income consisting of *whatever amount the manufacturer had agreed to pay,* including any payment in services. From the viewpoint of the purchasers, there is left to the purchasers in the *Signal* and *Bankline* cases depletion based upon gross income consisting of the difference between the market value of the wet gas and the amount which the lease owner received therefor, including the value of services received in kind.

All that was done by the court below in this case was to compute the "amount the manufacturer had agreed to pay" by including a payment in services. There is no inconsistency here with the *Signal* and *Bankline* cases since the contracts presented in these cases did not call for any such payment but merely for a cash payment. Certainly these cases did not preclude the inclusion in such amount of a payment in services; so far as they go, these cases are consistent with the instant case, although they do not pass specifically upon the basic question presented by the instant case.

The Solicitor General also asserts that "The production expense of the purchaser was not gross income of the seller," under any "definition of gross income."

Why cannot the value of services performed by one party to a contract constitute income to the other party for whom they are performed? For example, A performs services for B worth $100, in return for stock which cost

B nothing. The $100 is part of B's gross income. (Cf. *Heiner* v. *Crosby*, 24 F. (2d) 191 (C. C. A. 3rd, 1928).) In the instant case Wyoming Associated sold oil for cash plus performance by the purchaser of certain services "as part of the price for oil purchased" (R. 45, 150-1). Suppose that Wyoming Associated had sold its oil as produced from this particular set of wells, not for cash, but simply in return for performance on the part of The Midwest Refining Company, for the benefit of Wyoming Associated, of all the producing services utilized in producing oil from *another* set of wells. In that case, it could not be contended that the value of these services did not constitute gross income from the first set of wells. What difference does it make whether the services be performed with respect to the first set of wells or with respect to another set of wells, so long as the services have a definite money and economic value to Wyoming Associated? Suppose, further, that after Wyoming Associated had made an agreement, such as we postulate, that agreement had been modified to provide for a cash payment for the oil from the first set of wells, in addition to the continued performance of the aforementioned services. Certainly the *additional cash consideration* would not affect the result; the value of the services, specified by the contract as part payment for the oil, would continue to be part of the income of Wyoming Associated. It follows that since the agreement as *originally* made provided for a cash payment for the oil plus the performance of certain services as part of the purchase price, the value of these services is as much a part of the income of Wyoming Associated as the cash received.

This common sense analysis of the whole matter cannot be countered by saying, as the Solicitor General does at the bottom of page 11 of his petition for certiorari, that the value of the services was not part of the price or consideration for the oil but was a consideration for an agreement to sell the oil at less than market price. Why carve the contract up in this artificial way? Indeed, the very

statement of such an analysis is its own refutation; if the seller agreed to perform services in order to get oil at a lower price, the value of those services is obviously part of the total price paid for the oil.

The Solicitor General goes on to point out that the amount representing the value of the services was never physically received by the Wyoming Associated and was never entered in its books or in the respondent's books or in the income tax return as gross income.

The taxpayer is not estopped by this circumstance. *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481. If Wyoming Associated had gone through the form of including the value of the services in its taxable gross income, it would have been entitled to take the same item as an expense incurred on its behalf. Therefore, the inclusion of the item in gross income, later to be deducted as an expense, would have been a mere idle gesture on the part of the taxpayer, the omission of which in no wise prejudiced the Commissioner.

The lower court's decision with respect to percentage depletion does not call for review by this Court. The basic principle on which this point was decided by the court below is irrefutable, viz., that the value of services in a given case may constitute gross income. The case given here is one where the value of the services was by the very terms of the contract made a "part of the price for oil purchased." Because of the special nature of the contract, and the language employed, it is more than doubtful whether any other case like this exists. In any event, granting the fundamental principle that the value of services *may* constitute income, it is obvious that whether services do constitute income in any particular case depends on the special factual circumstances involved. The matter is really not one of general law but of contractual interpretation and not a matter of widespread importance to be passed upon by this Court.

Conclusion.

Wherefore, it is respectfully submitted that the petition for certiorari herein should be denied.

Respectfully submitted,

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December 14, 1937.

APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Sec. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source what-

ever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * *

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

Art. 221. *Depletion in the case of oil and gas wells.*—Under section 204 (c) (2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204 (c) (2) and this article, refers to the separate tracts or leases of the taxpayer.

Sec. 6, Article VII, Constitution of the State of Wyoming, accepting United States land grant.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 600

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

MOUNTAIN PRODUCERS CORPORATION,

Respondent.

BRIEF FOR THE RESPONDENT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 600

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

MOUNTAIN PRODUCERS CORPORATION,
Respondent.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 31) is reported in 34 B. T. A. 409. The opinion of the Circuit Court of Appeals (R. 151) is reported in 92 F. (2d) 78.

Jurisdiction.

Grounds of jurisdiction of this Court are noted in petitioner's brief.

Statement of Case.

The summary of the facts in the subdivision of petitioner's brief entitled "Statement" is accurate and sufficient in scope to serve as a general background to the discussion of the two totally separate questions here involved. Additional detailed facts, with record references, as well as corrections of factual

statements in other parts of petitioner's brief, we have placed in the two main subdivisions of this brief to which they apply respectively.

We shall adopt the names used by petitioner; that is, we shall refer to respondent's affiliate, The Wyoming Associated Oil Corporation as Wyoming Associated, to The Midwest Oil Company as Midwest, and to The Midwest Refining Company as the Refining Company.

POINT I.

Wyoming Associated is exempt from Federal Income Tax on the share of income received by it from the State School Lease.

Summary and Scope of the Argument.

On this point the court below held that the principle of *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, rules the instant case. The petitioner, in Subdivision I B of his brief,* challenges the validity of the decision of this Court in the *Coronado* and *Gillespie*† cases, and asks that these decisions be overruled. We submit that no such attack upon the

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* By a footnote to petitioner's brief (Pet. Br. 25) it is conceded that this attack upon the *Coronado* and *Gillespie* cases is not forecast by the grounds for certiorari urged in the petition in this case. Petitioner then refers to its memorandum, filed, not in this case, but in the *Bankline* case (No. 388, this term), in which some reference to conflict between the *Coronado* and *Jergins Trust* (*Burnet* v. *A. T. Jergins Trust*, 288 U. S. 508) cases was made. As the *Bankline* case deals with California tide lands, and not with State school lands, either in Oklahoma or in Wyoming, the question there presented is quite different from that here involved. See page 11 of this brief.

† *Gillespie* v. *Oklahoma*, 257 U. S. 501.

Coronado and *Gillespie* decisions is proper, in view of the limited grounds for review stated in the petitioner's petition for certiorari. In a footnote on page 25 of his brief, petitioner admits that the petition for certiorari was limited to the propositions (1) that the court below had improperly *extended* the *Coronado* case, and (2) that there was a substantial conflict with *Bankline Oil Co.* v. *Commissioner,* 90 F. (2d) 899 (C. C. A. 9th), certiorari granted No. 388, this Term. As thus indicated, there was no mention in the petition for certiorari of a desire to have the *Coronado* and *Gillespie* cases overruled; indeed, the clear indication in the petition for certiorari is that these decisions were accepted by petitioner. The decision of this Court in *Morehead* v. *New York, ex rel. Tipaldo,* 298 U. S. 587, 604, makes it clear that the review granted in this Court can be no broader than that sought by the petitioner in an application for certiorari. The *Morehead* case and many other cases support the proposition that this Court "confines itself to the ground upon which the writ was asked or granted".* The *Morehead* case is particularly in point because there this Court drew a distinction between a reconsideration of the constitutional question previously determined in the case of *Adkins* v. *Children's Hospital,* 261 U. S. 525, which had not been requested in the petition for certiorari of the *Morehead* case, and an examination of the question of whether the *Morehead* case could be distinguished on its facts from the earlier *Adkins* decision. The *Morehead* petition for certiorari being on this latter ground alone, the Court limited its consideration to this single point, and refused to re-examine the constitutional question decided in the *Adkins* case itself.

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* *Alice State Bank* v. *Houston Pasture Co.,* 247 U. S. 240, 242; *Zellerbach Paper Co.* v. *Helvering,* 293 U. S. 172, 182; *Helvering* v. *Taylor,* 293 U. S. 507, 511; *Johnson* v. *Manhattan Railway Co.,* 289 U. S. 479, 494.

Since the question of the present effect of the *Coronado* and *Gillespie* cases, if it be within the scope of this hearing, lies at the very threshhold of this phase of the case, we shall devote the first part of our argument to a discussion of the *Coronado* and *Gillespie* cases, pointing out that they are in no sense overruled by any of the decicions cited by respondent. The *Coronado* and *Gillespie* decisions of this Court, as well as the decision of the lower court in the instant case, recognize the immunity from tax burden of a trust fund or its income to the perpetual protection of which the good faith of the federal government has been pledged by compact with a State or Indian tribe. In the instant case:—(a) The character of the land from which the income was obtained, (b) the source of the State's title thereto (a grant from the United States for school purposes made when the State was admitted to the Union), and (c) the nature of the express trust "for the exclusive benefit of the public schools * * * forever inviolate and undiminished"*, under which the land and all income accruing to the State therefrom are held, are all identical with the corresponding elements in the *Coronado* case. These cases may be clearly distinguished from cases in which the fund or income claiming protection, though connected with some branch of government, is not so specifically dedicated to an unquestioned governmental function, such as public education, that any imposition of tax burden "would be such a direct interference with the functions of government itself" plainly beyond the taxing power. (*James* v. *Dravo Contracting Co.*, 82 L. Ed. Ad. op. 125, 138, quoting from *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 524). In terms of practical results that is what a tax will mean to the State of Wyoming, whether the immunity be treated as absolute as in the case of "public securities", or as qualified

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*Sec. 6, Art. VII, Constitution of the State of Wyoming, accepting United States land grant (quoted in Appendix, pp. 57-58).

and dependent upon degree of burden as in the case of certain types of independent contractors.

In subdivision IA of his brief, the petitioner seems to concede these elements of identity, but denies the applicability of the *Coronado* case upon the theory that the income received by Wyoming Associated is the income not of a lessee, but of a corporation having no "direct contractual relation" with the State, and upon the theory that in the instant case no tax is "laid upon an instrumentality of the government" (Pet. Br., 16, 21, 22).

Opposing this the respondent claims that even though the doctrine of the *Coronado* case be applied "strictly and only in circumstances closely analogous to"* those under which the doctrine had originated, it was no extension of the doctrine to apply it in this case for the reasons, *first,* that Wyoming Associated was in substance a direct lessee of the State of Wyoming, and, *second,* that if it were not a direct lessee, the income must be viewed as accruing to Midwest as trustee, and was hence exempt when passed on by it to its beneficiary, Wyoming Associated. The alleged distinction made in the dissenting opinion in the court below based upon cases of the *Wanless* type† does not, under these circumstances, as we shall point out, meet the issue.

I.

The Authority of the Coronado Case Is Not Impaired by any Later Decision.

Neither the *Gillespie* case nor the *Coronado* case has ever been overruled by this Court. The former case was decided some fifteen years ago, and the latter over five years ago.

---

* Quoted from *Burnet* v. *A. T. Jergins Trust, supra,* 516.

† *Wanless Iron Co.* v. *Commissioner,* 75 F. (2d) 779 (C. C. A. 8th), Certiorari denied, 295 U. S. 765, discussed on page 27 of this brief.

The fact that both decisions were by divided courts has not in any way restricted the reliance placed upon them by lessees dealing with types of property falling strictly within their scope. Both decisions have established rules of property, and large commitments, in the form of leases carrying royalties at extraordinarily high rates, have been made upon the faith of them.

It is naively suggested by petitioner (Pet. Br., 31) that this whole realm of tax law would be simplified if this entire field of tax exemption be abolished, thus making it unnecessary for any court to determine its proper limits. This neat disposition of the problem, consisting of a denial that it exists, is, of course, always available. But this Court has refused on many occasions to adopt that solution of a difficult problem. The argument of the Solicitor General is essentially the same as his argument in the *Dravo* case,—that the test of immunity be simply whether there is discrimination in the tax. Mr. Justice Roberts completely demolished this argument in his dissenting opinion in the *Dravo* case, and the majority opinion is most careful to state the conditions under which immunity shall continue to exist. In this respect the Solicitor General is here asking for a reargument of the *Dravo* case.

The *Dravo* opinions recognize the difficulty of determining the precise place at which this line between taxability and exemption shall be drawn when governmental instrumentalities of various types are involved. Both the majority and minority opinions do much, however, toward establishing landmarks and criteria. It is made clear by the majority opinion in the *Dravo* case, *supra,* 138—

> "* * * that the nature of the governmental agencies or the mode of their constitution could not be disregarded in passing on the question of tax exemption, as it was obvious that an agency might be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government 'that any taxation of it by the other would be such

a direct interference with the functions of government itself as to be plainly beyond the taxing power.' "

Instances of these agencies of one government, requiring absolute protection against taxation by the other, then given in the opinion, are (1) a government officer with respect to his salary, (2) public securities, (3) an agency created and controlled by a government exclusively to enable it to perform a governmental function.

In commenting upon another group of agencies not all of which are entitled under this rule to *absolute* exemption, the majority opinion refers to *Metcalf & Eddy* v. *Mitchell, supra,* 137, as a "pivotal decision" in which it was determined that an independent contractor, when he contracts with a government, does not have his earnings or compensation absolutely protected against taxation, but that in independent contractor cases the degree of burden—the substantial nature of the interference—must be scrutinized.

It is pointed out in the minority opinion that not all *independent contractors* are in this latter class possessing only qualified immunity, because *public securities,* admittedly entitled to absolute protection, represent nothing but independent contracts to lend money on the one side and to repay with interest on the other, from which it is argued that the converse of the rule in *Metcalf & Eddy* v. *Mitchell, supra,* is not true. To apply in the instant case the rule common to the majority and minority opinions in the *Dravo* case, the mere fact that Wyoming Associated may properly be called an independent contractor is not of itself enough to prove that its income from the contract cannot have absolute tax exemption; otherwise, holders of public securities would be excluded from exemption by the mere fact of independent contract. The *Coronado* case is, therefore, not discredited by pointing out that the lessee of Oklahoma school land was an independent contractor; neither is the instant case decided by the fact that Wyoming Associated entered into a lease with the State of Wyoming as an independent con-

tractor for motives, from its point of view, of private gain (Cf. Pet. Br., 9).

The net result of the classification of cases into those having *absolute* exemption and those having *qualified* exemption dependent upon substantial burden, adopted in the *Dravo* case, is that independent contractors dealing with the government are not like public officials in an absolutely exempt class by virtue of their status as contractors, but that particular contractors may or may not be entitled to absolute exemption, depending upon whether the nature of the public function to be performed by the contract is so "intimately connected with the * * * performance" of a government duty as to make that contract an essential instrumentality of the government itself. Certainly the majority opinion in the *Dravo* case recognizes that independent contractors may have the status of absolute exemption. As the *Gillespie* case is cited with approval in *Metcalf & Eddy* v. *Mitchell, supra,* and the latter case is in turn cited with approval in the *Coronado* case, while *Metcalf & Eddy* v. *Mitchell, supra,* is treated as a "pivotal decision" in the *Dravo* case, it would seem that each of these four cases is to be taken as modifying and explaining the others, and that there is no justification for jumping to the conclusion that the first and third in chronological order have been silently overruled.

We submit that the *Coronado* case (and with it along parallel lines the *Gillespie* case) can be reconciled with the *Dravo* case, and with all the many cases in this field collected in that decision, by taking either or both of two logical and non-conflicting views of the facts: (1) The recovery to the maximum extent of the mineral value of *school grant* land is so intimately connected with the performance of a State function that a lease from the State to an independent contractor is an instrumentality of government entitled to absolute tax exemption, or (2) the degree of burden resulting from taxing the income from the lease of such a *State school land* lessee is so substantial and direct as to make such a tax

a serious interference with government. We urge the view first stated. If there was ever a situation in which the protection which the State demands for services rendered by an independent contractor calls for immunity from tax burden, that case is one like the instant case, in which the burden is sure to interfere with the carrying out of a grant for public education.

One clear distinction between the *Coronado* case and the *Gillespie* case, on the one hand, and all the cases compared with them by petitioner on the other hand, is that in the first named of these cases a trust fund or trust income exists, to the inviolate and perpetual protection of which the federal government has by solemn compact pledged itself. For the taxing arm of this government to take back, whether directly or indirectly, a part of the fund or income so assured, as is threatened here, savors of bad faith and violates a solemn compact.

In the *Coronado,* and in the instant case, the ultimate source of the income sought to be taxed was land granted by the federal government to a State, for the purpose of common schools, at the time of its admittance into the Union. Realization of the full value of these lands for schools was an activity enjoined upon the State by the federal government, *to insure education* upon a permanent basis. In accepting the grant, the State in each case was required to throw around the subject matter of the grant protective clauses of its constitution, which are phrased in almost extravagant language.* It was in response to requirements of Congress that each State "pledged her faith",† and, by emphatic constitutional provisions such as these, threw every conceivable safeguard around these school land grants and the proceeds

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* Note such phrases as "exclusive benefit", "forever inviolate and undiminished", in Art. VII, Sec. 6, Wyoming Constitution (quoted in Appendix, pp. 57-58).

† *Burnet* v. *Coronado Oil & Gas Co., supra,* 398.

therefrom. The States have kept faith. They do not and can not make these grants self-supporting. The practice in Wyoming is to place even the salaries of officials who administer these lands, along with all other expenses of supervision which they occasion, upon the general funds of the State, leaving the gross revenue available for the purposes of the grant.

Where the realization by the State of the value in these lands takes the form of leasing on a royalty basis, the specific duty of the State is to get the highest possible royalty out of the lease.* If the proceeds of operation accruing to a lessee are received by it tax-free, it can afford to bid a higher rate than if they are not, just as tax-exempt bonds sell for a higher price than those the interest return on which is subject to income taxation. (*Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 581, 582, 586). Only by keeping this leasing power entirely free from tax interference can the compact with the State be kept.

In the *Gillespie* case the compact by which the revenue-producing land was governed was between the United States and Indians, the United States describing its duties with respect to the land as those of a guardian for Indian wards. It would have been inconsistent with this relationship for the judicial branch of the government to permit others to lessen the effectiveness of that compact-grant.

The significant factor in these cases is not alone the existence of something that may be called a "trust", though in each of them a trust of some sort with respect to property or revenue existed. There was also, prior to the execution of the lease, a trust in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, but there the trust *res*, being Texas lands never owned by the United States, had never become the subject of any compact to which the federal government was a party.

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* This duty is expressly embodied in Section 712, Wyoming Compiled Statutes, 1920 (printed in Appendix, pp. 60-61).

This reason is in addition to the rule of Texas law which there operated to sever the oil from the land and so to cut off any continuing title, trust or otherwise, of the State. *Burnet* v. *Harmel,* 287 U. S. 103, 109. The traditional distinction between proprietary and governmental functions is helpful in this problem but not completely determinative. In the *Jergins Trust* case, *supra,* a discussion of this distinction makes clear the phase of the question there involved. It is to be kept in mind that in the *Jergins Trust* case the property covered by the oil lease, though originally acquired by a city for the use of part of its surface and some of its subsurface strata for water, it had largely ceased to have any water uses, and that its deeper oil strata involved in the case had never had any significance to the city on any other than a purely proprietary basis. Moreover, the faith of the United States was never there committed to the protection of any fund.

THE IMPOSITION OF A FEDERAL TAX UPON WYOMING ASSOCIATED WOULD IMPOSE A DIRECT BURDEN UPON THE STATE OF WYOMING.

Petitioner urges that the imposition of a federal tax on the income of Wyoming Associated from Section 36 would not impose any direct burden on the State of Wyoming (Pet. Br., 18-19).

Whether the lease covering Section 36 be viewed as held and operated by Midwest as a trustee, or as owned by it and Wyoming Associated substantially as co-lessees, a distinction which we discuss in detail later in this brief, there would plainly be such a burden. If the relationship between Wyoming Associated and the State of Wyoming is direct, there is an obvious direct burden within the rule of the *Coronado* case. If we accept the petitioner's view that Midwest operated the entire lease and that Wyoming Associated was the beneficiary of a trust established by the

declaration of a trust of February 1, 1923, there is just as immediate a burden. Obviously, Midwest, acting pursuant to this so-called trust, must consult the beneficiary in entering into any lease, or at the very least, determine on its own responsibility the interests of its beneficiary. The moment Midwest either consults Wyoming Associated or considers its interests as beneficiary, the very burden which induced this Court to rule in the *Coronado* case that the income from State lands is exempt, comes into operation.

If the solution of this tax exemption problem is to be sought in practical results rather than in technical relationships (Pet. Br., 37, 38), the facts of this case meet the practical test. If in the deliberation between the trustee-bidder and its beneficiary-joint-operator, the parties are forced to decide that the proceeds going to the beneficiary are taxable, the bid must be figured on that basis. Proceeds half taxable or all taxable are the same in principle; the result is a lower bid. For this very practical reason, the entire lease, whether issued to one who operates entirely for himself, or to one who takes as trustee for a group, or to one who has no personal interest, acting merely as agent for a principal, is burdened by the imposition of a tax upon the income of either or both participants in it. The entire lease is the instrumentality of the State, and any tax upon the proceeds of such a lease will lessen the effectiveness of the instrumentality. Interests carved out by sub-lease, *after the lease* has issued, leaving the fundamental relationship of the State to the operation unchanged, present an entirely different question.

Petitioner ignores this vital distinction between factors which, because they exist when a lease bid is made, influence the rate of royalty to be received by the State, and factors which do not then exist, and hence, if they later come into existence, cannot change a subsisting lease. His argument (Pet. Br., 19), of no practical burden in the instant case, is based upon the erroneous assumption that Wyoming Asso-

ciated acquired its interest in the lease from Midwest after the lease came into existence. We shall point out in more detail (*infra*, p. 21) that the facts are exactly opposite.

At another place petitioner (Pet. Br., 38) tries to brush aside all practical considerations by asserting that the royalties bid by applicants for State leases are just based on geologic hopes and not on any consideration of probable expenses and results! The argument that the State will not suffer because those engaged in producing oil are lacking in business foresight is gratuitous. In any event, the facts here reveal very little opportunity for the exercise of talents of this sort. These State leases were of five-year terms. This particular lease followed thirteen years of operation and development of this identical tract of land under three earlier leases (R. 125, 131, 136, 141). The Salt Creek field was, in 1923, a well recognized developed field (R. 59), and finally the rate of royalty actually bid of 65% of gross production is far above any recognized or conventional rate of royalty in that or any other field.

ON THE ASSUMPTION THAT WYOMING ASSOCIATED WAS A BENEFICIARY OF A TRUST, THE INCOME FROM SECTION 36 RECEIVED BY IT AS BENEFICIARY WAS TAX EXEMPT.

In a later subdivision of this brief we shall contend, in line with what the court below stated in its opinion (R. 156) that Wyoming Associated was "in substance and effect" as much "a lessee of the lands (Section 36 covered by the school lease) as was the Midwest Oil Company, the lessee in name". Before passing to that point, however, we shall examine the results which would flow from the opposite inferences of fact contended for by the petitioner.

In his brief petitioner says (Pet. Br., 15): "The State has given Wyoming Associated no rights, and Wyoming Associated has assumed no obligations toward the State."; and again, (Pet. Br., 16): "It is unnecessary to decide

whether this instrument (the declaration of trust, R. 111) creates a trust interest in the lease or only in the net proceeds. In neither case does Wyoming Associated derive its income from the State or from the state oil land."; and again (Pet. Br., 20): "Here Wyoming Associated made no payments to the State, * * *. It did not operate the property, * * * the income from the lease is derived without its aid."; and finally, (Pet. Br., 23): "The lease contemplated that Midwest would (1) extract the oil, (2) deliver 65 per cent. of it to the State, and (3) sell it. Only after these three steps had been taken would Wyoming Associated be paid its share of the benefits and net proceeds".

Where does this argument lead? It means that the State lease was held and operated by Midwest *as a fiduciary,* and that Wyoming Associated received its half of the proceeds of the State lease *as a beneficiary of a trust.* If that be the case, these proceeds of production from the State lease were received by Midwest as fiduciary, and should be dealt with under Section 219 of the Revenue Act of 1926,* in force in the year 1925. It follows that the exemption established by the *Coronado* case applied to the income from the State lease as it came to Midwest *as trustee,* and the question here to be determined is the status of such income when passed on by a trustee to Wyoming Associated *as a beneficiary.*

The effect of Section 219 of the Revenue Act of 1926, effective for 1925, is that exempt income received by a trustee and passed on to a beneficiary is not taxable in the hands of the beneficiary. To state this point in greater detail, Section 219, subdivision (a), provides that the tax imposed by Parts I and II of Title II shall apply to the income of estates or of "any kind of property held in trust", including four classes, the one material to the present discussion being class (2), consisting of "income which is to be distributed currently by the fiduciary to the benefici-

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* This section is printed in full in the Appendix, pages 53-56.

aries * * *". The reference is obviously to taxable income. But if there be any doubt on this point, it is made clear by subdivision (b) of Section 219, which states that, except as provided in subdivisions (g) and (h) (not material to the present discussion) "the tax shall be computed upon the *net income* of the estate or trust, and shall be paid by the fiduciary". (Italics ours.) This reference is plainly to net income as defined in Section 212(a), which is "gross income, as defined in Section 213, less the deductions allowed by Sections 214 and 206". "Gross income", by the operation of Section 213(b), amplified by Article 71 of Regulations 65 and 69, excludes from the very starting point of this computation all "income exempted by statute or by fundamental law." The statute then goes on, in Section 219 (b) (2), to place the duty of paying the tax upon the *beneficiary* instead of upon the *fiduciary* when the income "is to be distributed currently by the fiduciary to the beneficiaries". The mechanism of this subsection is to allow the fiduciary a special deduction for currently distributable income, with a requirement that the beneficiary take up the amount of the deduction in his return. No new definition of income is introduced and obviously the term continues to mean income of a non-exempt character coming within the concept of "gross income" as used in the earlier part of this section.

Thus, the statute adapts to trusts the general scheme of taxation adopted in the Revenue Act of 1926 for individuals. The trust is taxable upon income not currently distributable by it, and the beneficiary is taxable with respect to income distributable (*Freuler, Adm.* v. *Helvering*, 291 U. S. 35) but no tax is contemplated upon any one, whether fiduciary or beneficiary, with respect to what is not "gross income" as defined in Section 213 of the Act. The State lease income received by Midwest as trustee, and passed on to Wyoming Associated, is not "gross income", and is not taxable to the trust estate. Nor is it taxable to the beneficiary when passed on to it. The State land income is, in the words

of Article 71 of Regulations 65 and 69, one of those "items of income exempted by statute or by fundamental law."*

In other words, if Wyoming Associated received its share of the revenue from the school lands under the terms of the trust, the only conceivable provision in the revenue act which might subject this distribution to tax in the hands of Wyoming Associated is Section 219. But Section 219 makes it plain that the amount in question is not taxable income. In this case there was no income (that is, gross income, as defined in the statute and regulations, of the estate or trust), and, therefore, there could be no taxable income to the beneficiary.

This result, flowing from the petitioner's interpretation of the facts in this case, is no strained or technical result. It is an ordinary instance of the universal practice. The trust department of a bank holds state and municipal bonds in trust for an ordinary citizen. Whether the proceeds of coupons be accumulated or currently distributed, no tax is paid either by the fiduciary or by the beneficiary. "Fundamental law" renders these proceeds tax exempt, and that quality excludes them from "income" in the tax sense. This immunity follows the proceeds into the hands of the beneficiary.†

This Court dealt with an analogous, but more debatable, situation in *Helvering* v. *Falk,* 291 U. S. 183. In that case the question involved was the right of beneficiaries of a trust to depletion with respect to royalties from an iron-ore mine. The royalties were collected by the trustees of the trust and currently distributed to the beneficiaries. It was held that

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* The same or a similar statement appears in other regulations. See Reg. 45, 62, Art. 71; Reg. 74, 77, Art. 81; Reg. 86, 94, Art. 22 (b)-1.

† This rule is fully recognized by the Commissioner; see Reg. 69, 65, Art. 83 (a), Art. 344. See also *Carson Estate Co.* v. *Commissioner,* 31 B. T. A. 607; G. C. M. 5138, CB VII-2, 54; IT 1641, CB II-1, 76.

the beneficiaries were the owners of the entire economic interest in the mine and as such were entitled to a deduction for depletion under the Revenue Acts of 1921, 1924 and 1926. The Commissioner argued that since Section 219 of the Revenue Act of 1924 expressly required the beneficiary to include in his return the portion of the income of a trust distributed to him, he is to be subjected to taxation on the whole amount to be distributed regardless of depletion. In rejecting this line of argument, this Court said, at page 189:

> "* * * But we cannot accept the view that this [the direction in Section 219 (b) that in cases of income which is to be distributed currently to the beneficiaries the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary] was intended to impose a tax upon that part of the proceeds which represents the return of capital assets, whenever this has been paid over to the beneficiary. In cases like the one before us so to hold would in practice result in taxing allowances for depletion, contrary to what we regard as the plain intent of the statute. * * * the trustees must be regarded as a mere conduit for passing them [proceeds of oil] to the beneficial owners. Part only of the proceeds was subjected to taxation. The other part was left untaxed and remained so in the hands of the beneficiaries."

The same conclusion is *a fortiori* in the instant case since the question is not a matter of deduction governed by statute, but is a matter of complete exemption, which is a constitutional matter. Thus, assuming that Midwest, the trustee, was the only direct lessee of the State, nevertheless, Wyoming Associated's (the beneficiary's) share of the income from such lease came to it *via* the trustee, which trustee, to use the term used by this Court in *Helvering* v. *Falk, supra,* was a mere "conduit"—to use the term used by this Court in *Douglas* v. *Willcuts,* 296 U. S. 1, 9, a mere "channel"—for the transmission of this exempt income to the beneficiary.

The decision of this Court in *Stone, et al., Trustees,* v. *White,* 301 U. S. 532, develops the underlying purpose of this statutory scheme for the taxation of trustee and beneficiary. There a trustee sought refund of a tax erroneously paid by it on income which should have been taxed, but was not taxed, to the beneficiary of the trust. This Court, after pointing out that an action to recover taxes, although at law, is equitable in its function, applied to the utmost the principles for which we are here contending. The Court said at pages 535-536 (italics ours):

> "In the present case it is evident that but a single tax was due upon the particular income assessed and that petitioners' demand arises from the circumstance that the tax was paid from the income by the trustees when it should have been paid by the beneficiary. If the court may have regard to the fact that so far as the equitable rights of the parties are concerned *petitioners, in seeking recovery of the tax, are acting for the account of the beneficiary,* it would seem clear that the case is not one in which the petitioners are entitled to recover *ex aequo et bono;* for under the construction of the will by the court below, which we adopt, any recovery in this action will be income to the beneficiary, and will deprive the government of a tax to which it is justly entitled and enable the beneficiary to escape a tax which she should have paid.
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> "It is said that as the revenue laws treat the trustee and the beneficiary as distinct tax-paying entities, a court of equity must shut its eyes to the fact that in the realm of reality it was the beneficiary's money which paid the tax and *it is her money which the petitioners ask the government to return.* Formerly, trustee and *cestui que trust* were likewise distinct in the eyes of the law, as they are today for many purposes. But whenever the trustee brings suit in a court which is free to consider equitable rights and duties, his right to maintain the suit may be enlarged or diminished by reference to the fact that the suit, *though maintained in the name of the trustee alone, is for the benefit and in the equitable interest of the cestui.*"

In the instant case it is respectfully urged that a court of equity should likewise take "cognizance of the identity in interest of trustee and *cestui que trust*" (p. 537). Such a conclusion is necessary as well to protect a solemn exemption as to protect the revenue.

WYOMING ASSOCIATED WAS IN SUBSTANCE A DIRECT LESSEE OF THE STATE OF WYOMING, OR A CO-LESSEE OF SECTION 36.

So far we have dealt with the question at issue on the basis of petitioner's assumption that there was no privity of contract between the State of Wyoming and Wyoming Associated. We shall now examine this assumption to see whether it can fairly be said that Midwest, and not Wyoming Associated, is to be treated as the real lessee of this half of the lease.

In the first place, uncontroverted evidence offered at the trial negatives any such assumption. It was shown at the trial that the oil produced from Section 36 (the State school section) was first collected into battery tanks where it was steamed and the impurities taken out (R. 61); that Wyoming Associated had a man employed at these battery tanks to gauge the oil and by his signature on run checks to make delivery of the oil to the gathering lines of the pipeline company (R. 61); that from the battery tanks the State of Wyoming's share of the oil was delivered to its nominee and the remainder of the oil divided equally between Wyoming Associated and Midwest (R. 61). Wyoming Associated received payment for its half of the oil direct from the purchaser, the Refining Company (R. 61, 115).

Not only did the State of Wyoming take delivery of the oil from Wyoming Associated, but testimony was offered at the trial by a person present at a conference between representatives of the State of Wyoming and representatives of Wyoming Associated relative to the leasing of Section 36 shortly before the lease of April 29, 1923, was made (R. 65). This conference, held at Cheyenne, Wyoming, in the early

part of April, 1923, was presided over by Governor Ross of the Wyoming State Land Board, and was attended by Mrs. Martin, Superintendent of Public Instruction of the State of Wyoming, and two or three other members of the Wyoming State Land Board (R. 65). Mr. Barnett, President of the Wyoming Associated, was present on behalf of that company (R. 65). The conference was in the nature of a public hearing, and was brought about by the Land Board of the State of Wyoming, to invite proposals for a renewal of the lease some eighteen months in advance of its expiration date (October 1, 1924) (R. 65). Wyoming Associated, through its president, Mr. Barnett, objected at the hearing to this procedure, arguing that it would have the effect of forcing Wyoming Associated, as well as Midwest, to bid higher royalties than they might have had to meet if the matter had been permitted to wait until a time nearer the expiration date of the lease (R. 65).

This last line of testimony offered at the hearing before the Board of Tax Appeals was objected to by counsel for the Commissioner, and was stricken out "for the reason that it is incompetent, irrelevant, and immaterial and an attempt to alter or vary the terms of a written instrument, a copy of which was attached to the stipulation of facts as Exhibit U-1". Counsel for respondent noted and was allowed an exception (R. 65-66) and urged this error in the Circuit Court of Appeals (R. 51).

Plainly this evidence shows direct dealings between Wyoming Associated and the State of Wyoming. It shows that in substance the Wyoming Associated was a co-lessee of Midwest actively operating a one-half interest in the State lease. Wyoming Associated was, therefore, in all respects an instrumentality or direct agency of the State, and in its own right was entitled to the exemption recognized in the *Coronado* case.

The rejected evidence was admissible, since the controversy was not between the parties to the instrument, but between one party to an instrument and a third party,—the Commis-

sioner of Internal Revenue.* Taking this excluded evidence in connection with the evidence to which no objection was made, that the State of Wyoming accepted deliveries of royalty oil, which it re-sold to the White Eagle or Empire Oil Companies (R. 66), the inference is irresistible that there was in practical fact privity of contract between the State of Wyoming and Wyoming Associated, and that the lease of Section 36 was in substance a joint lease to Midwest and Wyoming Associated, taken as a matter of convenience in the name of the Midwest Oil Company with full knowledge on the part of the officials of Wyoming that Wyoming Associated was in substance, though not in name, a party to the lease.

Even if Wyoming Associated be not regarded as appearing through its own officers at hearings on the issuance of the State school lease, nevertheless it would still be far from occupying a status analogous to that of a sub-lessee. If it was not represented by its own officers in the State leasing negotiations, it was certainly represented by Midwest, which thus acted as its agent. A corporation, being an artificial entity, must always act through others. What difference does it make whether it acted through the agency of its own officers or through the agency of another corporation?

Even if all evidence of direct dealings between the State of Wyoming and Wyoming Associated be ignored, the history of the State lease covering Section 36 plainly supports the holding of the Circuit Court of Appeals,—that Midwest and Wyoming Associated were:

> "* * * bound together by a trust agreement entered into before the lease by the State was made by which they were to have equal rights in the lease itself and the net proceeds realized from it in whichever name of the parties the lease or any renewal or extension should stand." (R. 156);

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* *Peugh* v. *Davis*, 96 U. S. 332; *E. C. Gatlin* v. *Commissioner*, 34 B. T. A. 50; *Appeal of Converse & Co.*, 1 B. T. A. 742; *Appeal of J. W. Solof*, 1 B. T. A. 776.

and that—

> "* * * In substance and effect the Wyoming Associated was as much a lessee of the lands as was the Midwest Oil Company, the lessee in name" (R. 156).

The Wyoming Associated's interest in the State school lease did not originate with the declaration of trust of February 1, 1923, but was one of the items of property acquired by it in the corporate reorganization out of which, in 1919, it arose (R. 57, 58; Ex. L-2, R. 99-100).

The particular lease in effect in 1925 was the fourth in a series of consecutive State school leases dating back to January 4, 1910 (R. 59), each of which, after the first, was in effect a renewal of the preceding lease, rates of royalty being fixed, when each renewal was granted, by public competitive bidding. Petitioner asserts that in Wyoming the lessee under these State school leases as they expired had no option of renewal (Pet. Br., 12). This assertion requires some qualification. At all times involved in this case, Wyoming, by statute,* recognized a preference right over other bidders in the securing of a new lease as attaching to the lessee whose term was expiring. The practical operation of this preference is intensified by other statutory provisions† protecting the investment of the old lessee in improvements on a lease in the event others should, by outbidding him, secure the renewal. A regulation of the Wyoming Board‡ admin-

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* Ch. 62, C. L. Wyoming, 1921, amending and reenacting Sec. 712 Wyoming Compiled Statutes, 1920. This section is printed in full in Appendix, pages 60-61.

† Section 718, Compiled Statutes, Wyoming, 1920, which is the same statute as that referred to in Paragraph 10 of the State school lease Exhibit U-2 (R. 131, 134). The text of this section as it now appears without significant intervening amendments as Section 91-804, Wyoming Revised Statutes, 1931, is printed in full in the Appendix, page 61.

‡ Regulation 75 of the Board of Land Commissioners, promulgated June 4, 1919. The full text of this regulation is printed in the Appendix, page 61.

istering these leases interprets this latter statute as giving in practice preference rights.

The first in this series of State leases (R. 141) was taken by a mining partnership of 19 members (R. 54). William Fitzhugh was the lessee named in this lease and he held it for the benefit of the partnership (R. 54). In 1911 Fitzhugh and one other member of this partnership assigned their interests in this lease to Midwest (R. 54). Later in the same year, Reed Investment Company acquired (R. 54) and took over (R. 146) from the other 17 members of the partnership their interests in the first State school lease. By an instrument of partition (R. 78) entered into between the dates of these two purchases, Midwest and Reed Investment Company agreed to segregate their respective interests in the section of land covered by this State school lease, a specific 240 acres to the former and a specific 400 acres to the latter. In 1912 Reed Investment Company was succeeded by California Oil Company (R. 55), and in June, 1919, the segregated interest of California Oil Company in the second school lease (dated December 26, 1914, and naming Midwest as lessee (R. 136)) was among the items of property going to Wyoming Associated (R. 57, 110). The third State lease, dated October 1, 1919, was issued in the name of Midwest (R. 131). On February 1, 1923, before this third lease had expired, Midwest and Wyoming Associated agreed to change their respective interests in this school section from segregated parts of it into undivided interests of equal size. This was part of a field program of avoiding excessive offset drilling (R. 58, 59). On the same date, February 1, 1923 (R. 59), the declaration of trust (R. 111) was entered into between Midwest and Wyoming Associated. The reference in this document to its superseding all other definitions of interest is explained in oral testimony before the Board (R. 62) as a reference to the 1911 partition agreement (R. 78) which had created the segregated tract operations.

This, in condensed form, is the background of the issuance on April 19, 1923, of the fourth State lease (R. 125), at an increased royalty of 65%, by the State of Wyoming to Midwest as nominal lessee. The interest of Wyoming Associated in the State lease was, therefore, of equal age and dignity with the fractional interest owned by the Midwest.

While Midwest was the nominal lessee from the State of Wyoming with respect to the entire section, and thus in a technical sense may be said to hold legal title to the lease, Wyoming Associated and its predecessors in interest possessed and dealt directly, prior to February 1, 1923, with a specific 400 acres, and subsequent to that date Wyoming Associated possessed and dealt directly with an undivided 50% interest in the entire section. The declaration of trust (Ex. N; R. 111), acknowledged formally this long-standing coordinate interest which Wyoming Associated and its predecessors in interest had held in this lease. The language of the trust instrument itself is not without significance. It says in part that (R. 112):

> "* * * The Midwest Oil Company doth hereby declare that it holds an undivided fifty per cent (50%) interest in said lease and in the benefits and net proceeds to be realized therefrom and all renewals and extensions thereof for the use and benefit of said The Wyoming Associated Oil Corporation, and reserves the beneficial interest in the remaining fifty per cent (50%) thereof to itself.
>
> "And in consideration of the creation of the foregoing trust, said The Wyoming Associated Oil Corporation hereby covenants that it will share all of the burdens and obligations hereafter accruing under said lease with The Midwest Oil Company in the fractions hereinabove set forth, and that in the event any renewal or extensions of said lease should be made in the name of The Wyoming Associated Oil Corporation, or in their joint names, then the interest thereunder shall be held by the recipient of said lease in trust for the benefit of itself and the other party hereto in the fractions hereinabove set forth."

While a formal relation of trustee and beneficiary may be established by the declaration of trust, the beneficiary covenants for an equal share of the "burdens and obligations hereafter accruing under said lease" (R. 112); and the instrument goes on to say, very pointedly, that if any renewal or extension of the lease is made, either in the name of Midwest or Wyoming Associated, the party in whose name the lease is taken will hold the lease for the benefit of the other party, to the extent of the other party's half interest therein. Nothing could reveal more clearly the true nature of the transaction or show how unimportant the technical form really was. *Palmer* v. *Bender*, 287 U. S. 551. Whether the lease was taken in the name of one party or of the other, or of both, was of no consequence.

In support of the opposite theory, that Wyoming Associated did not enjoy the status of a joint lessee, petitioner asserts (Pet. Br., 17) that Wyoming Associated "purchased the right to share in the profits realized by Midwest by surrendering more or less similar interests which it or its predecessors had possessed since the original Fitzhugh lease". This is indeed a triumph of form over substance. If we understand petitioner correctly, he claims that even if Midwest and Wyoming Associated were joint lessees in this State school lease prior to February 1, 1923 on the basis of Midwest owning and operating a segregated 240 acres and Wyoming Associated owning and operating a segregated 400 acres, the essence of this relationship would be lost if, to avoid offset drilling, they agreed that from and after February 1, 1923, each would own an undivided one-half interest in the entire lease. Out of this exchange of a segregated for an undivided interest in the identical property, petitioner spells an *acquisition* of its interest in the lease by Wyoming Associated from Midwest!

We may pass over this technical argument because, whatever its merits, this so-called "purchase" spent its force with the expiration of the State lease then in effect. This oc-

curred October 1, 1924, before the commencement of the tax year in question. As noted by the court below, when the lease dated April 19, 1923, which governed the taxable year 1925, was taken by Midwest, it and Wyoming Associated were already bound together by the terms of a declaration of trust through the operation of which the interest of Wyoming Associated in the lease came into existence at the very commencement of the lease by operation of law and was in no sense acquired by it from Midwest. This interest cannot, even on technical grounds, be viewed as a subordinate, derivative, or inferior interest of any sort.

The petitioner points out (Pet. Br., 15) the absence of any assignment of a 50% interest in the lease of April 19, 1923 from Midwest to Wyoming Associated. There was no occasion for anything of the sort. The declaration of trust preceded the lease. To the extent of a 50% interest Midwest acquired the lease as an agent or as a trustee; the consideration for the lease—the agreement to pay the Wyoming school fund a royalty of 65%—moved in equal parts directly from the two equitable co-owners, and in substance they stand, from the instant this lease came into existence, upon exactly the same plane, one with the other. The State school lease, with respect to each, is the instrumentality through which the State of Wyoming performs its duty,—a duty imposed by Congress in the land grant portion of the Act of Admission and accepted by the Constitution of Wyoming, to utilize the proceeds of this land "for the exclusive benefit of the public schools * * * forever inviolate and undiminished".

We have shown, from the long history of the State lease and from the relations between the parties revealed in the declaration of trust itself, that Wyoming Associated was a real party in interest with a direct interest in the lease itself. In view of these facts, it is respectfully urged that the terms "trustee" and "beneficiary" are either completely inappropriate as applied to Midwest and Wyoming Associated, or the terms must be understood as related to a dry,

naked and passive trust in which the trustee has no duties as such, and the beneficiary holds direct enjoyment of the property. See *Lewis & Co.* v. *Commissioner,* 301 U. S. 385, 388.

The purpose of tax laws, and certainly of the federal income tax, is to impose the burden of taxation upon the real owner of the income. This well established rule in connection with the burden of the tax is equally well established in determining who shall receive exemption in the case of tax-free income. This simple principle should control the decision in the instant case. *Bettendorf* v. *Commissioner,* 49 F. (2d) 173 (C. C. A. 8th); *Central Life Assurance Society of the U. S. Mutual* v. *Commissioner,* 51 F. (2d) 939 (C. C. A. 8th).

THE WANLESS AND HOBART CASES ARE NOT APPLICABLE.

The respondent has no quarrel with the principles established by many of the cases cited by the petitioner in his brief on the State land point. Most of these cases do not touch the issue in the instant case. It is desired, however, to point out in careful terms the distinction between the instant case and the decision of the Eighth Circuit Court of Appeals in the *Wanless Iron* case, *supra,* and the decision of the Sixth Circuit Court of Appeals in *Hobart Iron Co.* v. *Commissioner,* 83 F. (2d) 25 (C. C. A. 6th), certiorari denied 299 U. S. 543. It is argued by the petitioner (Pet. Br., 20, 25, 30) that under the doctrine of these cases, Wyoming Associated did not hold the lease directly from the State of Wyoming and that the *Coronado* doctrine is inapplicable.

In the *Wanless* case the lease issued by the State had been first assigned and then parcelled out by the assignee, Wanless Iron Company, to operating sublessees. The income which the taxpayer, Wanless Iron Company, received, in the language of the court was (p. 781) "not from an actual operation of the mines, but in the form of royalties received in turn from its sublessees". These sublessees paid

the State its full royalty directly, and in addition, under the terms of the subleases, paid the taxpayer an intermediate profit. The court likens the situation to that in *Willcuts* v. *Bunn,* 282 U. S. 216, where this Court had drawn a distinction, for tax purposes, between profits realized on the sale of municipal bonds, and the coupon yield of the bonds themselves. Under these circumstances, it was entirely proper, in the *Wanless* case, to hold that there should be no tax exemption.

In the instant case Wyoming Associated made its own royalty settlements with the State of Wyoming by making delivery *to the State's nominee* of royalty oil in kind. It sold its fraction of the oil remaining direct to the Refining Company and collected its part of the proceeds without any intervention of Midwest with respect thereto (R. 61). The arrangement between Midwest and Wyoming Associated was in no sense an assignment under which the assignee received income from any sublessee. Midwest retained no intermediate royalty as did the Wanless Iron Company.*

The same underlying distinction disposes of the decision of the Sixth Circuit Court of Appeals in *Hobart Iron Co.* v. *Commissioner, supra.* There a mine belonged to the State of Minnesota; the State leased the mine to Sullivan and Hale for 50 years for a royalty of 25 cents per ton of iron ore mined. Sullivan and Hale subleased the mine to the taxpayer for the lesser term of 44 years, the taxpayer agreeing to pay Sullivan and Hale a royalty of 10 cents on each ton

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* In *Ohio Oil Company* v. *United States,* 1936 C. C. H., Par. 9415 (D. C., N. D. Ohio, W. D.), unreported elsewhere, this distinction between a beneficiary and trustee relationship and the sublease relationship of the *Wanless* case is adopted. In the *Ohio Oil* case the lease was taken in the name of a person who held it from the beginning in trust for the taxpayer. The court held that this did not take the case out of the rule of the *Coronado* case. The land was Wyoming State school land. Taxpayer's income was held exempt.

of ore mined. The taxpayer in this case was a *sublessee of a lessee* from the State of Minnesota. As the terms and royalty rate of any such sublease are of no concern to the State, its underlying royalty fixed by the original lease remaining unchanged, there is no burden on the State in having the profits of a sublessee held taxable. In the instant case, there being no sublessee relationship on any theory, the royalty rate which the State is able to obtain on a lease and on successive renewals will rise or fall depending on whether the bidder can count on tax exemption. Whether the bidder deals directly or bids through a trustee makes no difference in practical result.

POINT II.

"The gross income from the property", within the meaning of Section 204(c)(2) of the Revenue Act of 1926 on which the 27½ per cent depletion allowance of Wyoming Associated should be computed, includes not only the cash part of the sale price of its oil, but also the value of services received by it from the Refining Company under the contract.

Summary and Scope of the Argument.

Wyoming Associated sold the oil from its properties* to the Refining Company under a contract which expressly required the Refining Company to perform certain services

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* The point in this case dealing with exemption of State school lease income has only this one point in common with the depletion point now under discussion: The school lease gross income and unreturned cost are separately determined by the Board (R. 36, 37, 38) and petitioner does not claim to be entitled to both exemption and depletion upon the income from that particular lease.

"as part of the price for oil purchased" (R. 120). The gross income from the property of Wyoming Associated for percentage depletion purposes, therefore included the value of these services. This express provision of the contract was a natural and proper term expressing the actual transaction between the parties. By reason of the date upon which the contract was written no motive of tax avoidance could have been present. No conflict exists between the decision of the court below and the *apportionment of depletion* cases noted in the petition for certiorari. The petitioner in fact concedes that the Refining Company had no depletable interest in these leases.

As to subdivision II-B of petitioner's brief (Pet. Br., 51) in which he seeks now to question the measure of value to be applied to these services, we submit his discussion falls outside the scope of this review and should be disregarded. This measure of value was embodied in a stipulation before the Board, was found by the Board to be the correct measure of value for use if any value representing the services is to be included in gross income, and it was not challenged by petitioner either in the court below or in his petition for certiorari.

GROSS INCOME FROM THE PROPERTY INCLUDES VALUE OF SERVICES WHICH ARE BY EXPRESS CONTRACT MADE PART OF THE SALE PRICE OF THE OIL.

The question before the Court is the proper construction of Section 204(c)(2) of the Revenue Act of 1926, which provides that a reasonable depletion allowance shall be "27½ percentum of the gross income from the property" during the taxable year, provided, *first*, that the allowance shall not exceed "50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property", and, *second*, that the allowance shall not be less than it would be without reference to this paragraph. No question as to the applicability of either of these two

qualifications is presented.* The sole question is the proper meaning of the phrase "gross income from the property", used in Section 204(c)(2). More precisely stated, the question is whether the term "gross income from the property" is to be limited to cash actually received, or may include income received, constructively or otherwise, in the form of services.

The term "gross income", as used in Section 204(c)(2), is to be taken in the same broad sense in which it is defined in Section 213† for the purposes of the entire income tax *title*. The statute, for the obvious purpose of protecting

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* On page 40 of his brief petitioner makes the somewhat confusing statement that "Before the Board the respondent also relied on depletion based on cost in lieu of percentage depletion (R. 22, 32, 45)." This relates to separate lease tracts other than those upon which respondent claimed, and was allowed, under the opinion of the court below, percentage depletion. Exhibit V to the stipulation of facts (R. 145) lists the 43 separate lease tracts (other than the state school lease) owned by Wyoming Associated in the tax year 1925. In the proceeding before the Board respondent established the cost of these properties segregated by tracts. This was a higher cost than that first conceded by the Commissioner in the deficiency notice. As to this Board determination of cost no appeal was taken by either party. In the recomputation of tax under Board Rule 50, which resulted from the Board's decision, respondent was given the benefit of cost depletion on specific leases with respect to which cost gave higher depletion than the percentage depletion computed by the Board. The appeal to the Circuit Court of Appeals was, and consequently this review is, concerned only with those particular leases upon which percentage depletion, as computed under the legal theories of the Board, is higher than cost depletion, but lower than percentage depletion would be if the elements of income contended for by respondent are recognized. As all these additional elements of income are segregated in the stipulation by separate tracts, there is no difficulty in applying the correct rule of law to the respective leases when that rule of law is established.

† See petitioner's brief, page 48.

the revenue, reveals an intention on the part of Congress to reach pretty much every sort of income subject to the federal power.* The statute speaks of income as including "gains or profits and income derived from any source whatever."

Having adopted this term "gross income", to the comprehensive definition of which a whole section of the Act is devoted, as a basis for percentage depletion, it is to be presumed that Congress meant, in Section 204(c)(2), to allow depletion upon the basis of the same broad concept of income. Any decision narrowing the definition of the term "gross income", as used in Section 204(c)(2), will have its inevitable repercussion upon the concept underlying Section 213.

The Court below took the position, urged by respondent, that the gross income from the property during the taxable year consisted not only of the cash payments from the Refining Company to Wyoming Associated, but also of the cost of production expended by the Refining Company under its contract (Ex. T-2, R. 118) which provided that these production costs should be a "part of the price for oil purchased" (R. 120). The Court below saw no "just or logical reason" why this cost of production, which was expressly made a part of the purchase price by contracts antedating the enactment of the Revenue Act of 1926, in which percentage depletion was first allowed, should not be added to the cash payments for the purpose of determining gross income. The Court goes on to say (R. 154):

> "Certainly it should be unless pure technicalities of the taxing laws be invoked. Had the Wyoming Company produced the oil at its own expense, its gross income would have been the amount which it received from the oil sold and the only difference would have been that it would have received in cash the propor-

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* *U. S.* v. *Safety Car Heating & Lighting Co.*, 297 U. S. 88, 93.

tionate amounts which represented the cost of production. Under such conditions there should be no question of its gross income including the oil produced and sold to cover production costs. It cannot logically be less than an element of gross income because the cost of production by another is a component part of the purchase price of the oil. There is no criticism on the part of the Government either as to the fairness of the purchase price or of the cost of production covered by the contract between the Wyoming Associated and the Midwest Refining and therefore it would seem unnecessary to analyze these schedules; nor can any charge be made that there was any effort on the part of the taxpayer to enter into a contract for the purpose of favorably affecting its tax liability."

THE PRODUCTION SERVICES RECEIVED BY WYOMING ASSOCIATED WERE PART OF THE PRICE FOR OIL SOLD BY IT TO THE REFINING COMPANY, AND GROSS INCOME OF WYOMING ASSOCIATED FROM THE PROPERTY; IT IS THEREFORE IMMATERIAL THAT SUCH SERVICES WERE PERFORMED BY THE REFINING COMPANY, NOT ONLY FOR WYOMING ASSOCIATED, BUT ALSO FOR ITS OWN BENEFIT.

Petitioner contends throughout Point A of the second division of his brief (see pp. 41, 42, 47), that the production operations performed by the Refining Company cannot constitute "gross income" to Wyoming Associated for the reason that such services were performed by the purchaser "for his own benefit" (Pet. Br., 42). It is not claimed by petitioner that services may not constitute gross income. On the contrary, petitioner admits that one who exchanges a share of stock for the services of a physician "may realize income based on the difference between the cost or other basis of the stock and the value of the services to him * * *" (Pet. Br., 42). It is argued by petitioner that the instant case does not fall within this admission,—that the services rendered by the Refining Company do not constitute gross income in the present case,—because, so the petitioner argues, the

Refining Company performed the services, received in the instant case by Wyoming Associated, *for its own benefit.*

Clearly, it is irrelevant that the Refining Company acted *for its own benefit.* The argument that motivation of self-benefit in the performer of the services necessarily excludes the services from being income to the recipient proves too much. It prevents the value of services from ever constituting income, and the petitioner admits in his doctor analogy that services may constitute income. All commercial and business transactions are carried on by each side for the purpose of obtaining self-benefit. Cash may be paid and commodities may be surrendered by a person intending to benefit himself. Such cash and commodities are none the less income to the recipient.

Obviously, we have to inquire more deeply into a transaction involving services if we would determine whether services constitute income. What is it that makes the services of the physician in petitioner's hypothetical case income to the recipient? As we have shown above, it cannot be lack of self-benefit to the physician, for benefit to him does accrue. The determinative fact is that the services are the consideration for the stock, just as in the instant case the services under discussion are part of the consideration for oil. Being part of the consideration paid for an article sold, they are part of the purchase price received. Being part of the purchase price received, they are part of the seller's gross income.

The fundamental thing which makes the services of the physician in petitioner's hypothetical case, and the services of the Refining Company in the instant case, part of the purchase price, is that they were agreed to be paid for something which has been sold or exchanged. The agreement of the parties is what makes a purchase price, and consequently determines gross income of the seller. This becomes apparent when we examine the language which does not fit the facts of the case, but which the petitioner has to employ, to

express his argument. He says (Pet. Br., 42) that "where, as in the present case, oil production operations are conducted by a purchaser *for his own benefit* in order to obtain the oil at a contract price which he may deem favorable, those operations are not income of the seller of the oil". It is noteworthy that in this statement the petitioner omits all reference to the vital fact that the purchaser had *agreed* to conduct these production operations in a contract providing for the sale of oil by Wyoming Associated, and that this agreement expressly provided (not in a "recital" as contended at p. 46 of petitioner's brief but in a substantive provision of the contract, R. 120) that the services would constitute part payment for the oil sold.

The decisive fact is not, as stated by petitioner (Pet. Br., 42), that the production operations were conducted by the Refining Company. The decisive fact is that the Refining Company *agreed* to conduct the operations in a contract which explicitly provided that the services should be part of the purchase price of the oil. The conducting of the operations merely carried out the agreement and constituted a performance of a contract for the sale of oil under which services were part of the purchase price. The provisions of the contract are plain, direct and simple, and read as follows (R. 120):

> "From the date of this Agreement until the First day of January, 1934, as part of the price for oil purchased hereunder, the Refining Company will drill, case, and maintain all wells, find and supply water, install and operate pumps when necessary, clean, shoot, and otherwise stimulate production of wells as necessary, and conduct all development and production operations upon said lands necessary or proper for the protection and conservation of the oil and gas contained therein and for the production of oil therefrom in such amounts and from such wells as will prevent the drainage of the oil content of said lands through wells belonging to other operators, and will, at all times during said term, maintain the development of and production from

> said lands at such rate that the production of oil therefrom shall be proportionate to the production of oil in other parts of the Salt Creek Field. * * *"

In other words, the services are to be performed by the purchaser "as part of the price for oil purchased hereunder".

When we come to examine the other clauses and provisions of the contract, we find that the words "part of the price for oil" were not chosen at random. They are in harmony with the actual arrangements for the sale and disposition of the oil. For example, Article III, Section 2, of the contract (R. 121) provides that the Refining Company "will take delivery of the oil purchased hereunder at the outlet gates of the measuring tanks located at or near the wells on said lands". Steaming for separation of water or the breaking down of emulsion is referred to later in the same Section. Obviously, this was a delivery of oil as chattel property, not only after severance from the land, but also after market preparation.

This same provision as to point of oil delivery governed risk of fire loss (R. 63). If a loss occurred prior to the passage of the oil through the tail gate of a measuring tank, it fell on Wyoming Associated, but if the loss occurred after the oil passed that point, the loss fell on the Refining Company and Wyoming Associated would be paid the full price for the oil.

In other words, Wyoming Associated agreed to sell and deliver oil to the Refining Company after it had been lifted from the ground and impurities had been removed from it. These services had to be performed prior to the delivery of the oil and the passage of title thereto. Prior to the signing of a contract the seller was under no obligation to employ the Refining Company to perform the services; it could have done the work itself or employed another company to do the work. In any event, the production and lifting services had to be performed by someone in order to enable the seller to make delivery of the oil. The seller chose as a matter of

convenience to have the purchaser perform these services for it. This it did by hiring the Refining Company to perform the services. It agreed to accept performance of this work "as part of the price for oil purchased".

In view of the services to be rendered by the purchaser, it is reasonable to suppose that that part of the contract price which the purchaser was obligated to pay in cash was fixed below an amount which would have represented the prevailing market prices of oil. This we find to have been the case in the taxable year in question (R. 37, 145).

Once we have arrived at the inevitable conclusion that under the circumstances of this case the value of the services was intended by the parties to constitute part of the purchase price for the oil, there is no more reason for refusing to regard the value of these services as part of the gross income of the seller than there is in the case in which the owner of stock sells his stock for physician's services, or than there is in refusing to recognize cash itself as a purchase price of oil if the parties have agreed upon a definite sum. A simple illustration will serve to fortify this conclusion.

Let us suppose that the Wyoming Associated had sold its oil supply from this particular set of wells, not for cash in any amount whatever, but solely in return for performance on the part of the Refining Company under a contract of all the producing services necessary to lift oil from *another* set of wells. In that case, it could not be contended that the value of these services did not constitute the gross income of Wyoming Associated from the first set of wells. What difference does it make whether the services are performed with respect to the first set of wells or with respect to another set of wells, so long as the services have a definite money and economic value to Wyoming Associated? If Wyoming Associated should modify such an agreement so as to provide for a cash payment for the oil from the first set of wells, in addition to the continued performance of the afore-

mentioned services, the *additional cash consideration* would not affect the result; the value of the services, specified by the contract as part payment for the oil, would continue to be part of the income of Wyoming Associated. It follows that if the agreement as *originally* made provided for a cash payment for the oil plus the services the result would still be that the value of the services are gross income to Wyoming Associated from the property.

By his use of an excerpt from *Eisner* v. *Macomber,* 252 U. S. 189, 207, petitioner, at page 42 of his brief, implies that only things of "exchangeable value" may be included in gross income for any purpose. There is no broad unqualified rule that a taxpayer has no income unless he receives something which he may exchange. This is settled by decisions of this Court (See, e.g., *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Boston & Maine R. R.,* 279 U. S. 732; see also *Raybestos-Manhattan, Inc.* v. *United States,* 296 U. S. 60). In the first two cited cases this Court held that a taxpayer might receive taxable income in the form of a payment of taxes on its behalf. Such a payment is a substantial benefit, but it is nothing that may be assigned or transferred to someone else. It is also established by decisions of this Court that any reduction of liability constitutes taxable income (*United States* v. *Kirby Lumber Co.,* 284 U. S. 1; *Douglas* v. *Willcuts, supra*).

These principles are illustrated in the recent decision of this Court in *Helvering* v. *Midland Mutual Insurance Company* (300 U. S. 216). In that case the Court held that a mortgagee bidding in mortgaged property at a foreclosure sale at the amount of the principal of the mortgage loan plus accrued interest, and taking over the property in satisfaction of the whole debt *without payment and repayment of any cash,* was, with respect to interest included in the bid, in receipt of taxable income, even though the property, when acquired, might be worth less than the amount of the principal alone. The theory of the decision is that the mort-

gagee is not to be excused from paying tax because it received "a credit rather than money or other tangible property." In spite of the fact that the credit was not entered on the mortgagee's books as income, the Court viewed the transaction as if the accrued mortgage interest had been collected along with the principal, pointing out that the discharge of the debt included the interest accrued. The Court says (pp. 224-225):

> "* * * Where the stranger makes the purchase, the debt is discharged by a payment in cash; where the mortgagee purchases the property, the debt is discharged by means of a credit. The amount so credited to the mortgagor as interest paid would be available to him as a deduction in making his own income tax returns. It would be strange if the sum deductible by the mortgagor debtor were not chargeable to the mortgage creditor as income received. * * *
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> "* * * There is nothing unfamiliar in taxing on the basis of the legal effect of a transaction."

This goes further than the instant case. The amount of production expense advanced by the Refining Company under its contract with Wyoming Associated, constituting expressly as it does, part of the purchase price of oil under that contract, is a much more substantial item of income than was the implied or constructive credit in favor of the mortgagor in the *Midland* case. Furthermore, this Court, in the *Midland* case, specifically recognized the deductibility of the credit by the mortgagor, who had paid nothing, but had merely surrendered his property in discharge of the mortgage debt.

The court below treated the decision in *Boulton* v. *Heiner*, 3 F. Supp. 372 (W. D. Pa.) as a precedent upon the point of recognizing services as constituting income under appropriate conditions. The court in the *Boulton* case was, as the court below states, confronted with a matter of determining whether or not the value of services under a contract should

be included with cash payments in fixing the cost of stock for the purpose of ascertaining the profit from the sale thereof. The court below then quotes from the *Boulton* case as follows (R. 154):

> "'The plaintiff claims in the present suit that in addition to the amount of money actually paid by him for the stock in question in order to acquire it, he was compelled by his contract with the other incorporators and with the original owners of the properties taken over by the corporations, to expend labor and effort which was worth at least the sum of $17,500. The uncontradicted testimony shows that this service was agreed upon and rendered; that it was worth $17,500; and that plaintiff received no compensation therefor other than by the right to acquire the stock. Under these circumstances it is our opinion that the plaintiff is entitled to claim that the cost of his stock was not merely $11,500, the amount of money paid, but also $17,500, the value of his services rendered pursuant to his agreement'."

The petitioner in his brief (p. 47) states that the *Boulton* case is distinguishable. No analysis of the case is there given. Since in the doctor analogy he also, on page 42 of his brief, adopts substantially the facts of the *Boulton* case as the illustration of circumstances under which services may be income, this reference to the *Boulton* case appears to be a part of the matters we have discussed above.

We do not advance the *Boulton* case as being on all fours with the case at bar. The principle enunciated is, however, significant. The court decided that where property is sold for cash and for services rendered under a contract to perform them as a part of the purchase price, the value of the services constituted an integral part of the cost of the property.

Respondent's Interpretation of the Contracts Between the Wyoming Associated and the Refining Company Is the Natural Logical View of Such Contracts, and It Is the Petitioner's Interpretation of Such Contracts Which Is Artificial and at Variance with the Facts.

This case might perhaps be different if the contracts in question had been drawn with a view of tax avoidance or with a view of building up to the highest possible figure the "gross income from the property". As the opinion of the lower court observes (R. 154), this is not true, since the contracts are dated February 1, 1923, and the percentage depletion provision of the statute (Section 204(c)(2) of the Revenue Act of 1926) was not enacted until February 26, 1926, retroactively as to this provision to January 1, 1925. (Revenue Act of 1926, Section 286.) This was the first time the federal revenue acts contained any provision for percentage depletion. Percentage depletion was inserted in the Revenue Act of 1926, applicable to years beginning with 1925, to replace the predecessor discovery value provision of the revenue acts of earlier years. See *Helvering* v. *Twin Bell Oil Syndicate,* 293 U. S. 312, 318.

Being unable to attack the contract on this ground, the petitioner urges an interpretation of the contract completely out of line with its obvious purposes and completely at variance with the facts in the record. It is said that Wyoming Associated "chose not to engage in the oil-producing business and preferred the business of allowing the purchaser to engage in the risks of production" (Pet. Br., 46). This statement shows the petitioner's lack of understanding of the dual capacity of the Refining Company under its contracts with Wyoming Associated. It was found by the Board as a fact, upon the basis of substantial evidence (R. 35), that under these contracts the Refining Company was acting as agent for Wyoming Associated down to the point of delivery of the oil. Then, but not until then, it became a vendee. This was after the oil had been completely severed from the realty

and prepared for delivery. This means that the Wyoming Associated did not choose not to engage in the oil-producing business; it engaged in such business through the instrumentality of the Refining Company. The petitioner goes on to argue (Pet. Br., 46) that "different types of business produce different gross incomes from the property", this being "true generally of any taxpayer who owns raw material and chooses to permit a purchaser to prepare it for the market rather than to engage in that business himself"; and urges that the Wyoming Associated, as an owner of oil, did not prepare its product for delivery and sale, but preferred "to charge a lower cash price and to permit the purchaser to undertake the work and expense of preparing the product and making delivery", from which the petitioner concludes that it cannot be said "that the seller's price is the cash price plus the value of the services to him" (Pet. Br., 47).

This is turning the contract completely upside down. The Wyoming Associated did not sell oil under the ground; it sold oil severed from the ground and treated for delivery to the pipe line. True, the extraction of the oil and the treatment thereof above ground was physically accomplished by the Refining Company. But at this stage of the operation the Refining Company did not own any oil; it was performing services, as its contract with Wyoming Associated clearly required it to do, for Wyoming Associated, which did own the oil. Wyoming Associated was not preferring to charge a lower cash price or lessening its work and lowering its price; on the contrary, its price was carefully and deliberately stipulated in the contract as including the services rendered by the Refining Company.

The respondent is not attempting "artificially" to construct its gross income "as if he had engaged in the producer's business" (Pet. Br., 47). There is nothing artificial about the respondent's claim. It is rather the petitioner who is artificially interpreting the provisions of the contract into a type of transaction which never occurred.

THE TOTAL CONTRACT PRICE URGED BY THE RESPONDENT WAS LESS THAN THE FIELD PRICE OF OIL IN THE TAXABLE YEAR, AND IT IS IMMATERIAL IF IN SOME FUTURE DEPRESSION PERIOD PRICE OVERTURNS MAY HAVE TEMPORARILY REVERSED THIS NORMAL RELATIONSHIP.

Petitioner in his brief goes to considerable pains (Pet. Br., 43) to show that conditions might, or possibly in the worst of the depression years did, occur under which the cash part of the price (which the petitioner, begging the question, refers to as the contract price), might amount to more than the prevailing market prices of the oil. Petitioner supports this assertion by a footnote (Pet. Br., 44) showing that in the extraordinary price upset of the depression which was superimposed upon abnormal crude oil supply from the East Texas field, *retail prices* of gasoline fluctuated much less than crude oil prices. Petitioner seems to overlook the fact that in the contracts involved in the instant case, even the cash part of the price is based not upon *retail prices of gasoline,* but upon a composite of the *wholesale* prices received by a specified refiner for *gasoline* and *kerosene* (R. 119).

It is not essential to our case to show that the total price adopted in the contract must be either above or below the open market price of oil at any specific time. Prices under contracts for a period of time frequently get out of step with current open market quotations. That does not prevent contract prices from controlling the dealings and the taxes of the parties. The only use we have made of any argument based on the relationship of total contract price, cash plus services, to open market price is to point out that this total contract price for which we contend was a price reasonably to have been anticipated by the parties, being, on the average over the year 1925, somewhat under the then current market price of like oil (R. 48).

The Twin Bell Decision Lends No Support to Petitioner's Position.

In the argument beginning at page 48 of his brief, petitioner at several points cites the decision of this Court in *Helvering* v. *Twin Bell Oil Syndicate,* 293 U. S. 312. We are not sure that we entirely follow this part of petitioner's argument. On page 50 petitioner quotes at some length, from page 321 of the opinion in the *Twin Bell* case, a statement to the general effect that a particular interpretation of a statute will not be adopted merely because any other interpretation may work unjust and unequal results. The argument on respondent's part to which this answer has been addressed, pointing out the greater uniformity of effective tax rate which results from our interpretation of the depletion section of the law, was made originally to the Board, but was not made by the respondent to the court below, and is not now urged in this Court. Even before the Board this was not presented as a basic argument necessary to the establishment of the taxpayer's contention, and was omitted before the Circuit Court of Appeals because the respondent believed that there was some force in the Board Member's reply to this particular argument.

Another part of this argument of the petitioner (Pet. Br., 48) appears to be that even if the production services are "gross income" they are not "gross income *from the property*" (Italics ours). This is only a new form of petitioner's contention, dealt with above, that the services are not gross income. If they constitute gross income at all, it is because they are the selling price of oil stipulated in the sales contract. Since the oil is the product of the property, all elements of its selling price, including an element payable in a form other than cash, is necessarily "gross income from the property".

The quotation from the *Twin Bell* opinion at page 49 of petitioner's brief, taken in its context, deals entirely with the apportionment provision (Sec. 234 (a)(8)). The ex-

cerpt quoted requires apportionment of the depletion allowance as well in a case in which a lessee sells the royalty owner's oil and pays over the royalty in the form of cash, as in a case in which the lessee turns over the royalty oil in kind to the lessor.* From this quotation petitioner draws the quite different conclusion that Congress did not intend "that in addition to the contract price some value to the seller, to be placed on production operations by a purchaser, should be included in the seller's gross income from the property".

In this argument petitioner completely begs the question. The relationship of the parties involved in the *Twin Bell* case was that of lessor and lessee, not seller and purchaser. The respondent is not trying, as in the *Twin Bell* case, to add to its "gross income from the property" someone else's "gross income from the property". The issue in the instant case is: What is the Wyoming Associated's "gross income from the property"? For purposes of analogy to the *Twin Bell* case, it owns the entire property. The respondent's position is simply that part of the gross income from that property is received in the form of services. A decision to the effect that someone else's "gross income from the property" should not be part of the taxpayer's basis for percentage depletion has no bearing upon the determination of what is the taxpayer's "gross income from the property".

In other words, the *Twin Bell* decision has application only where there is divided ownership. The explicit denial by petitioner of any contention on his part that "the Refining Company has a depletable interest in the oil represented by production expenses or any other sum" (Pet. Br., 52), removes our problem from the class of cases to which the *Twin Bell* decision belongs.

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* See *Thomas* v. *Perkins*, 301 U. S. 655, 662.

RESPONDENT AGREES THAT THE REFINING COMPANY HAD NO DEPLETABLE INTEREST IN THE LEASES, BUT RESPONDENT'S INTERPRETATION OF THE CONTRACTS BETWEEN THE WYOMING ASSOCIATED AND THE REFINING COMPANY DOES NOT EXCLUDE THE POSSIBILITY OF A DEPLETABLE INTEREST IN THE REFINING COMPANY.

This leads to the answer to petitioner's point on page 52 of his brief. The argument there is that even though the Refining Company has no depletable interest in the oil, the acceptance of the respondent's contention will, nevertheless, "bar the purchaser from depletable interest."

We agree here with the government's contention that an interest in oil or gas, or some type of ownership, is essential to the right to a depletion deduction (Pet. Br., 52). Petitioner's application of this rule is, however, based upon a complete misconception of the opinion of the court below in the instant case. Since no one but Wyoming Associated owned any interest in the oil and gas, it might well have been argued by respondent that the "entire allowance" of depletion should be given to Wyoming Associated, as the petitioner seems to think has been done. If the market value of the oil is taken as representing the base for computation of "entire allowance" this has not been done, for Wyoming Associated has not been given, for depletion purposes, the market price of oil times barrels produced. The decision of the court below (R. 154) simply permits the inclusion in gross income, for percentage depletion purposes, of the cash contract price of oil plus the value of the services rendered pursuant to the contract "as part of the price for oil purchased" (R. 120). The total gross income computed under the lower court's decision amounts to $7,423,055.74 (the cash contract price of $4,606,535.70 plus a value of services proved by production cost of $2,816,520.04; R. 145), whereas the total gross income calculated with reference to the market price of oil would be $8,411,450.19 (a production in the year

of 4,640,794.50 barrels times the stipulated average field price of $1.808605 per barrel; R. 37). The difference of $988,394.45 is available as a basis for depletion to the purchaser if the purchaser should be held entitled thereto. Therefore the decision of the court below does not deprive the Wyoming Associated's purchaser of any possible depletable interest (see Pet. Br., 52). On the contrary, it leaves, as a basis for such depletable interest, the substantial sum of $988,394.45.*

THE RETURN FILED BY RESPONDENT AND THE BOOKS OF ACCOUNT OF WYOMING ASSOCIATED ARE NEITHER CONCLUSIVE, NOR OF ANY EVIDENTIARY VALUE.

Petitioner argues (Pet. Br., 43) that evidently Wyoming Associated itself did not regard the value of production services as gross income because it did not include this item

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* The Solicitor General is, perhaps, misled by the fact that before the Board of Tax Appeals respondent, at that time petitioner, claimed, alternatively, that the market value of the oil afforded a yardstick to measure the value of the services—in other words, that the total market price would be one way of showing the total price, i. e., cash plus the value of the services. If the taxpayer had stood upon this position before the Circuit Court of Appeals and had been sustained by that court, there might be some ground for the Solicitor General's statement that the Circuit Court of Appeals decision left no possibility of any depletable interest in the purchaser and was, therefore, in conflict with the *Bankline* case and *Signal Gasoline Corp.* v. *Commissioner*, 66 F. (2d) 886 (C. C. A. 9th). But the taxpayer, when it came before the Circuit Court of Appeals, elected to rely upon the cost to the purchaser of performing its services as a sounder measure of value, hence, instead of claiming depletion based on the market price of the oil, the taxpayer asked for depletion only on a lesser sum made up of the contract price of the oil plus the value of the productive services rendered by the purchaser as proved by the stipulated cost thereof. The opinion of the court below permits a computation of depletion only on this basis.

on its books or in its income tax return. The position taken in the return is, of course, not binding on respondent (*Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481). Nor are bookkeeping entries binding (*Helvering* v. *Midland Mutual Insurance Co., supra,* 223; *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, 187). But the failure to include the item as gross income on the books or in the income tax return does not even furnish any substantial evidence that Wyoming Associated did not regard the item as gross income. For, had Wyoming Associated gone through the form of including the value of the services in its taxable gross income, it would have been entitled to deduct the same item as an expense incurred on its behalf. The inclusion of the item in gross income, later to be deducted as an expense, would therefore have been an idle gesture on the part of the Wyoming Associated, and its failure to include the item in gross income obviously does not prove that the Wyoming Associated did not regard the item as income.

So far as the value of the services is concerned, the respondent did do the one thing which was of any practical importance. In the return filed it computed percentage depletion on an amount of gross income which, on its then theory, included the value of these services.* To have included the value of the services in the taxable gross income and then to have deducted the same amount as an expense, while it might have satisfied the meticulous requirements of a more pedantic bookkeeping, would have served no useful purpose.

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* This was done by taking 27½% of an amount consisting of the barrels of oil produced from the properties of the company at the market price prevailing in the field in 1925 (R. 37). This was because the respondent at the time of making the return regarded the difference between market price and cash contract price as the fairest method of measuring the value of the services to be included in gross income. This method of taking the value of the services into account for depletion purposes was presented by the respondent before

NO QUESTION OF THE CORRECTNESS OF ANY PARTICULAR MEASURE OF VALUE TO WYOMING ASSOCIATED OF THE PRODUCTION OPERATIONS IS BEFORE THIS COURT.

On page 51 of his brief petitioner introduces another question not covered by his petition for certiorari.* He contends that even if the value of the production operations were property includable in the gross income of Wyoming Associated, the stipulated cost of these services is not a correct measure of their value. No such objection to the measure of value used was made by the Commissioner even before the Board. In fact these costs were all segregated by lease tracts and the results were embodied in a stipulation of facts (R. 59, 145), upon which the case was heard by the Board. The Board Member in his opinion finds with respect to the value thus established by these stipulated costs (R. 40):

> "* * * The value fixed or placed by the parties upon the services rendered would seem to be none other than the actual cost of such services, which is the amount actually expended by the Midwest Refining Co. in producing the oil and not necessarily the difference between the market value and the contract price of the oil. There is no evidence nor reason apparent to us to justify the assumption that such costs as stipulated do not represent the full costs of operation of the properties."

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the Board of Tax Appeals as an alternative to its present computation (R. 38). The opinion of the Board Member expresses a distinct preference for actual cost of these services as a method of valuation—if they are admissible at all—rather than the difference between the market value and the cash part of the price (R. 40). When the case came before the Circuit Court of Appeals the respondent in effect reduced its claim, and took this simpler way to compute the value of such services, namely the actual cost (R. 153).

* For a discussion of the impropriety of this procedure, see pages 2-3 of this brief.

The Commissioner took no cross appeal on this point,* and the court below (R. 154) adopted these stipulated costs as a perfectly satisfactory measure of their value to Wyoming Associated. No specification of error is made by petitioner upon the point (Petition for Certiorari, 7).

The introduction of this question into petitioner's brief in this Court is an attempt to go behind issues of fact upon which the parties were in complete agreement before the Board. The lack of any basis now to reconsider this question of measures of value has been dealt with by this Court in *General Utilities Co.* v. *Helvering*, 296 U. S. 200, 206:

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

See also *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37.

This rule applies with even greater force in such cases as the present in which the whole issue was closed by stipulation in the Board, and was not challenged in any way before the Circuit Court of Appeals. See *Helvering* v. *Gowran*, 58 S. Ct. 154.

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* See *Helvering* v. *Pfeiffer*, 58 S. Ct. 159.

CONCLUSION.

It is submitted that the judgment of the Circuit Court of Appeals is correct and should be affirmed on both of the issues presented.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 204. * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * * *

(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in

which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

* * * * * * * *

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

(1) There shall be allowed as a deduction (in lieu of the deduction authorized by paragraph (10) of subdivision (a) of section 214) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214, or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, mainte-

nance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

(d) If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as

are, under this section, required to be included in computing his net income. Any remaining portion of such amounts specified in subdivisions (a) and (b) of section 216 shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year.

(f) A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits such part of the amount so distributed or made available as represents the items specified in subdivisions (a) and (b) of section 216.

(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

(h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life

of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor.

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

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(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * * * *

Admission of Wyoming Into the United States.

The admission of the Territory of Wyoming into the United States is an historical matter of public record. The circumstances of this admission were, briefly, as follows:

Congress organized the Territory of Wyoming in the year 1868. The land comprised in the Territory was, at that time, part of the public domain of the United States. Section 14 of the Act of Congress of July 25, 1868 (15 Stat. at Large 178), creating the Territory of Wyoming, reserved Sections 16 and 36 in each township of the Territory then being formed "for the purpose of being applied to public schools in the state or states hereafter to be erected out of the same."

In the years 1889 and 1890 the people of Wyoming Territory adopted a proposed constitution for the State of Wyoming. This constitution in Article VII, Sections 1, 2, 4, 6 and 7, and Article XVIII, Sections 1 and 2, deals with these land grants. The articles and sections referred to are as follows:

ARTICLE VII.

"Section 1. Public schools. The legislature shall provide for the establishment and maintenance of a complete and uniform system of public instruction, embracing free elementary schools of every needed kind and grade, a university with such technical and professional departments as the public good may require and the means of the state allow, and such other institutions as may be necessary.

"Sec. 2. School revenues. The following are declared to be perpetual funds for school purposes, of which the annual income only can be appropriated, to-wit: Such percentum as has been or may hereafter be granted by congress on the sale of lands in this state; all moneys arising from the sale or lease of sections number sixteen and thirty-six in each township in the state, and the lands selected or that may be selected in lieu thereof; the proceeds of all lands that have been or may hereafter be granted to this state, where by the terms and conditions of the grant, the same are not to be otherwise appropriated; the net proceeds of lands and other property and effects that may come to the state by escheat or forfeiture, or from unclaimed dividends or distributive shares of the estates of deceased persons; all moneys, stocks, bonds, lands and other property now belonging to the common school funds.

* * * * * * * *

"Sec. 4. Restriction in use of revenues. All moneys, stocks, bonds, lands and other property belonging to a county school fund, except such moneys and property as may be provided by law for current use in aid of public schools, shall belong to and be securely invested and sacredly preserved in the several counties as a county public school fund, the income of which shall be appropriated exclusively to the use and support of free public schools in the several counties of the state.

* * * * * * * *

"Sec. 6. Trust Funds. All funds belonging to the state for public school purposes, the interest and income

of which only are to be used, shall be deemed trust funds in the care of the state, which shall keep them for the exclusive benefit of the public schools, and shall make good any losses that may in any manner occur, so that the same shall remain forever inviolate and undiminished. None of such fund shall ever be invested or loaned except on the bonds issued by school districts, or county bonds of the state, or state securities of this state, or of the United States, or on first mortgages on farm lands or such other securities as may be authorized by law.

(Note: The above Sec. 6 is in the form given to it by an amendment adopted in 1916.)

"Sec. 7. Application of school funds. The income arising from the funds mentioned in the preceding section, together with all the rents of the unsold school lands and such other means as the legislature may provide, shall be exclusively applied to the support of free schools in every county in the state."

ARTICLE XVIII.

"Section 1. Land grants accepted—Price limit. The state of Wyoming hereby agrees to accept the grants of lands heretofore made, or that may be hereafter made by the United States to the state, for educational purposes, for public buildings and institutions and for other objects, and donations of money with the conditions and limitations that may be imposed by the act or acts of congress, making such grants or donations. * * *

"Sec. 2. Application of proceeds. The proceeds from the sale and rental of all lands and other property donated, granted or received, or that may hereafter be donated, granted or received, from the United States or any other source, shall be inviolably appropriated and applied to the specific purposes specified in the original grant or gifts."

The United States Congress, with this proposed Wyoming constitution before it, thereupon created the State of Wyoming by an "Act of Admission" referring to the Wyoming

constitution as being "Republican in form and in conformity with the Constitution of the United States". Sections 4, 5 and 12 of the Act of Admission of July 10, 1890 (26 Stat. at Large 222), are as follows:

"Sec. 4. That sections numbered 16 and 36 in every township of said proposed state, and where such sections, or any parts thereof, have been sold or otherwise disposed of by or under the authority of any act of Congress, other lands equivalent thereto, in legal subdivisions of not less than one-quarter section, and as contiguous as may be to the section in lieu of which the same is taken, are hereby granted to said state for the support of common schools, such indemnity lands to be selected within said state in such manner as the legislature may provide, with the approval of the Secretary of the Interior; *Provided,* That section 6 of the act of Congress of August ninth, eighteen hundred and eighty-eight, entitled 'An act to authorize the leasing of the school and university lands in the Territory of Wyoming, and for other purposes,' shall apply to the school and university indemnity lands of the said State of Wyoming so far as applicable.

"Sec. 5. That all lands herein granted for educational purposes shall be disposed of only at public sale, the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of said schools. But said lands may, under such regulations as the legislature shall prescribe, be leased for periods of not more than five years, in quantities not exceeding one section to any one person or company; and such land shall not be subject to preemption, homestead entry, or any other entry under the land laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes only.

* * * * * * * *

"Sec. 12. That the State of Wyoming shall not be entitled to any further or other grants of land for any purpose than as expressly provided in this act; and the lands granted by this section shall be held, appropriated, and disposed of exclusively for the purposes herein men-

tioned, in such manner as the legislature of the state may provide." (Act of Congress, July 10, 1890.)

SESSION LAWS OF WYOMING, 1921; "CHAPTER 62":

"Section 1. That Section 712, Wyoming Compiled Statutes of 1920 be amended and re-enacted to read as follows:

"Section 712. The state board of land commissioners and also the state board of school land commissioners shall severally lease all state and school lands belonging to the state in such manner and to such parties as shall inure to the greatest benefit and secure the greatest revenue to the state. Preference shall in all cases be given to applications for leases of either state or school lands to persons who are resident citizens and taxpayers of the state, and applications made by citizens of the state who hold title to lands nearest to any state or school lands applied for and have actual and necessary use for the land applied for and are not applying for the lease for speculation or sale shall be given a preference right over all other applicants to lease the same at such rental as the board shall deem equitable and just; provided, that such preference right shall not be given as against the application of the old lessee who has made valuable improvements upon the lands applied for or on lands in the vicinity thereof, if the board shall find that such preference right will work extreme financial hardship upon such old lessee, or will greatly impair or destroy the value of a ranch or property which has been built up in connection with the lands applied for or of which it forms an important and necessary part, and such preference shall extend to an area of lands equal to twice the area of lands to which such applicant holds title, not, however, to exceed six hundred and forty acres of school or educational institutions lands, or a total of two thousand five hundred and sixty acres of state and school lands. Where two or more applicants claim preference by reason of holding title to lands nearest to lands applied for, the boards shall grant leases upon a basis as nearly equitable as possible. Applications for lease under this section must be filed with the commissioner of public lands

prior to the expiration of any existing lease on the lands applied for and where preference rights under this section are claimed, the basis of such rights must be shown at the time of filing an application for lease, but such showing may be made subsequently and within the time allowed by the commissioner of public lands, provided the application for lease is on file prior to the expiration of the existing lease."

WYOMING REVISED STATUTES, 1931:

"91-804. If mineral lands upon which improvements have been made shall be sold or if such lands shall be leased to other than the owner of the improvements thereon, then such purchaser or such new lessee shall pay to the owner thereof the value of said improvements, at an agreed price with the owner thereof; or if such agreement cannot be reached, then at such price as shall be fixed by appraisement under the authority of the board of land commissioners. The word 'improvements' shall be construed to mean surface improvements, machinery and other equipment used and necessary for the operation of the plant on such land, and work performed in the development of the property for operation and mining when such development work is of practical use in future mineral operations on such land. Wells drilled for oil which do not produce oil in commercial quantities, shafts, tunnels or drifts from which coal or other minerals have been practically exhausted, shall not be considered as improvements. (L. '07, c. 81, §5; C. S. '10, §622; L. '15, c. 80, §2; C. S. '20, §718.)"

REGULATIONS OF BOARD OF LAND COMMISSIONERS ADOPTED JUNE 4, 1919:

"75. No statutory right of renewal of an operator's lease exists, but it is the policy of the Boards to give great consideration to the improvements, expenditures and equity rights of former lessees in granting operator's leases. (Sec. 619, Wyo. Comp. Stat., 1910.)"

SUPREME COURT OF THE UNITED STATES.

No. 600.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Mountain Producers Corporation.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

[March 7, 1938.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

Respondent, Mountain Producers Corporation, owned all the capital stock of the Wyoming Associated Oil Corporation and filed a consolidated income tax return for the year 1925. Two distinct questions are involved with respect to the taxable income of the above-mentioned affiliate. These are (1) as to the amount of the gross income of the affiliate for the purpose of the statutory allowance for depletion in the case of oil and gas wells (Revenue Act of 1926, Sec. 204 (c) (2), Sec. 234 (a) (8)); and (2) as to a claim of exemption from taxation of income received by the affiliate under a trust agreement with the owner of an oil and gas lease from the State of Wyoming. The Board of Tax Appeals decided against respondent upon both points (34 B. T. A. 409) and its decision was reversed by the Circuit Court of Appeals. 92 F. (2d) 78. Because of an asserted conflict with a decision of the Circuit Court of Appeals for the Ninth Circuit in the case of *Bankline Oil Company* v. *Commissioner*, 90 F. (2d) 899, (see *Helvering* v. *Bankline Oil Company*, decided this day), we granted certiorari. — U. S. —.

First.—Wyoming Associated, organized in 1919, held certain placer mining claims, leases and operating agreements in the Salt Creek Oil Field in Natrona County, Wyoming. Pursuant to the Oil and Gas Leasing Act of Congress of February 25, 1920, the company exchanged its placer claims for government leases and later certain exchanges were made with the Midwest Oil Company and the Wyoming Oil Fields Company. In 1923, Wyoming Associated made a contract with the Midwest Refining Company by which the former agreed to sell to the latter all the oil produced by it in the

Salt Creek Oil Field and the Refining Company agreed to purchase such oil until January, 1934, upon a sliding scale of prices based upon the average price received by the Refining Company for gasoline and kerosene. Wyoming Associated agreed to give the Refining Company free use of all storage facilities, pipe lines, buildings and equipment, and so much of the oil and gas produced as might be reasonably necessary for production purposes. The Refining Company agreed, as part of the price of the oil thus purchased, to drill, case and maintain all wells, supply water, install and operate pumps, and conduct all development and production operations. The Refining Company agreed to take delivery of the purchased oil at the outlet gates of the measuring tanks located at or near the wells.

Respondent contended that the gross income of Wyoming Associated from its properties during the taxable year, for the purpose of the statutory allowance for depletion, consisted of the total cash payments received by Wyoming Associated, plus the cost of production defrayed by the Refining Company under its contract. The amount of that cost was shown by stipulation. The Board of Tax Appeals limited the gross income of Wyoming Associated to the cash payments received. The Circuit Court of Appeals was of the opinion that the cost of production incurred by the Refining Company should be added in the view that, had Wyoming Associated produced the oil at its own expense, its gross income would have been the amount which it received for the oil sold and it would thus have obtained in cash the proportionate amount which represented the cost of the production.

Laying emphasis upon the provision of the contract that the Refining Company should perform its services as a part of the purchase price of the oil, respondent contends that it is irrelevant that the Refining Company acted for its own benefit; that the production and lifting services were performed prior to delivery of the oil, and that the Refining Company was acting as the agent for Wyoming Associated down to the point of delivery and not until then became a vendee; that thus Wyoming Associated did not sell oil under the ground but oil severed from the ground and treated for delivery; that it was not essential for respondent to show that the total price under the contract must be either above or below the market price at any specified time, and that the price as fixed by

the contract controlled the dealings and the taxes of the parties. Respondent agrees that an interest in oil or gas or some type of ownership is essential to the right of deduction for depletion and assumes that no one but Wyoming Associated owned any interest in the oil and gas in place.

The Government argues that the cash price received for the oil is the seller's entire "gross income from the property" where, as in this instance, the oil is purchased under a contract by which a refiner agrees to defray the expense of the development and production operations and to pay a cash price based on the prices it obtains for the products it sells at its refinery; that the oil production operations were conducted by the Refining Company for its own benefit in order to obtain the oil at a price it deemed to be favorable; that the method of determining the purchase price under the contract was not related to the field market price of oil but was expressly related to a different basis, which might be greater, that is, to a basis consisting of the current prices obtained by the Refining Company for its gasoline and kerosene; that if the development operations had been unsuccessful and no oil had been produced, the services of the Refining Company would still have been paid for by the owner's promise to sell at a fixed price whatever oil might be produced, and that this should be taken to be the meaning of the provision that the Refining Company should perform its services as part of the price for oil purchased; that the owner of oil in place, instead of preparing it for delivery and sale, may prefer to lessen his work, lower his price and thus decrease his gross income from the property and in such case the services which the buyer may perform are not to be regarded as part of that income.

We think that the Government's argument is sound. The evident purpose of the statutory provision controls. It is a unique provision to meet a special case. Analogies sought to be drawn from other applications of the revenue acts may be delusive and lead us far from the intent of Congress in this instance. Congress has recognized that in fairness there should be compensation to the owner for the exhaustion of the mineral deposits in the course of production. *United States* v. *Ludey*, 274 U. S. 295, 302. But to appraise the actual extent of depletion on the particular facts in relation to each taxpayer would give rise to problems of considerable perplexity and would create administrative difficulties which

it was intended to overcome by laying down a simple rule which could be easily applied. To this end, the taxpayer was permitted to deduct a specified percentage of his gross income from the property. See *United States* v. *Dakota-Montana Oil Company*, 288 U. S. 459, 461. Congress was free to give such an arbitrary allowance as the deduction was an act of grace. In answer to the contention that the provision may produce "unjust and unequal results", we have remarked that this is likely to be so "wherever a rule of thumb is applied without a detailed examination of the facts affecting each taxpayer". *Helvering* v. *Twin Bell Syndicate*, 293 U. S. 312, 321.

The rule being of this sort for obvious purposes of administrative convenience, we must apply it in the simple manner it contemplates. The 27½ per cent. allowed is a fixed factor, not to be increased or lessened by asserted equities. The term "gross income from the property" means gross income from the oil and gas (*Helvering* v. *Twin Bell Syndicate, supra*) and the term should be taken in its natural sense. With the motives which lead the taxpayer to be satisfied with the proceeds he receives we are not concerned. If, in this instance, the development operations had failed to produce oil, it would hardly be said that the expense of drilling, borne under contract by another, constituted "gross income" of the taxpayer within the meaning of the statute. Nor, when oil or gas is produced, does the statute base the percentage on market value. The gross income from time to time may be more or less than market value according to the bearing of particular contracts. We do not think that we are at liberty to construct a theoretical gross income by recourse to the expenses of production operations. The Refining Company for its own purposes undertook the expense of those operations, and Wyoming Associated was content to receive as its own return the cash payments for the oil produced, leaving to the Refining Company the risks of production.

We are of the opinion that the cash payments made by the Refining Company constituted the gross income of Wyoming Associated and was the basis for the computation of the depletion allowance.

Second.—The State of Wyoming, in 1919, made a lease for the term of five years to the Midwest Oil Company covering a section of "school land" (section 36, township 40 north, range 79 west) for the purpose of producing oil and gas, reserving a royalty to

the State. The lease was superseded in 1923 by another lease of like import, running from 1924, the royalty to the State being fixed at 65 per cent. of oil and gas produced. In 1923, the Midwest Oil Company executed a declaration of trust, that it held an undivided 50 per cent. interest in the lease, and in the net proceeds to be realized therefrom, and all renewals thereof, for the benefit of Wyoming Associated. In 1925, the State received the agreed royalty of the oil produced and the proceeds of the sale of the remaining oil were divided between Wyoming Associated and the Midwest Oil Company.

The question is whether Wyoming Associated is subject to a federal income tax with respect to the amount it thus received. Immunity is claimed upon the ground that in this relation Wyoming Associated is a state instrumentality.

By the Enabling Act, the land in question was granted to the State of Wyoming for educational purposes, the proceeds to constitute a permanent school fund. Authority was given to lease such land for not more than five years. Act of July 10, 1890, c. 664, secs. 4, 5, 26 Stat. 222, 223. Apart from the fact that the claim is made by Wyoming Associated by virtue of the declaration of trust, and not by the lessee, the case would fall directly within the decision in *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, relating to a federal tax upon net income derived by a lessee under a lease of "school lands" by the State of Oklahoma. In *Burnet* v. *Jergins Trust*, 288 U. S. 508, we limited the application of the *Coronado* case, saying that the doctrine invoked was to be applied strictly. But a distinction solely upon the ground that the income in the instant case was received under a declaration of trust by the lessee, and not by the lessee itself, does not appear to be substantial and we are of the opinion that the *Coronado* case and the decision upon which it rested should be reconsidered in the light of our other decisions as to the taxing power.

The *Coronado* case was decided as a corollary to the case of *Gillespie* v. *Oklahoma*, 257 U. S. 501. The court there denied to Oklahoma the right to enforce its tax upon net income derived by a lessee from sales of his share of oil and gas received under leases of restricted Indian lands. See *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklahoma*, 240 U. S. 522. As Oklahoma was thus barred

from enforcing its tax upon the income of a federal lessee of Indian lands, the Court in the *Coronado* case held that a similar principle should be applied to the enforcement of a federal tax upon the income of the State's lessee of school lands. In such a case, as the State was executing a trust imposed by Congress as a condition of the State's entering the Union, the cases in which the State had engaged in business enterprises, apart from what should be deemed to be its essential governmental functions, were thought to be inapplicable. 285 U. S. p. 400.

The ground of the decision in the *Gillespie* case, as stated by Mr. Justice Holmes in speaking for the Court, was that "a tax upon the leases" was "a tax upon the power to make them, and could be used to destroy the power to make them" (240 U. S. p. 530) and that a tax "upon the profits of the leases" was "a direct hamper upon the effort of the United States to make the best terms that it can for its wards". In the light of the expanding needs of State and Nation, the inquiry has been pressed whether this conclusion has adequate basis; whether in a case where the tax is not laid upon the leases as such, or upon the government's property or interest, but is imposed upon the gains of the lessee, like that laid upon others engaged in similar business enterprises, there is in truth such a direct and substantial interference with the performance of the government's obligation as to require immunity for the lessee's income. We have held that the ruling in the *Gillespie* case should be limited strictly to cases closely analogous (*Burnet* v. *Coronado Oil & Gas Co., supra*), and the distinctions thus maintained have attenuated its teaching and raised grave doubt as to whether it should longer be supported.

In numerous decisions we have had occasion to declare the competing principle, buttressed by the most cogent considerations, that the power to tax should not be crippled "by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality and there is only remote, if any, influence upon the exercise of the functions of government". *Willcuts* v. *Bunn*, 282 U. S. 216, 225, and illustrations there cited. Thus we have held that the compensation paid by a State or a municipality to a consulting engineer for work on public projects may be subjected to a federal

income tax (*Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 524) and that the income of independent contractors engaged in carrying on government enterprises may be taxed. *James* v. *Dravo Contracting Company,* decided December 6, 1937. We have always recognized that no constitutional implications prohibit a non-discriminatory tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency. *McCulloch* v. *Maryland,* 4 Wheat. 316, 436; *Railroad Company* v. *Peniston,* 18 Wall. 5, 33; *Alward* v. *Johnson,* 282 U. S. 509, 514. The Congress may tax state banks upon the average amount of their deposits, although deposits of state funds by state officers are included. *Manhattan Company* v. *Blake,* 148 U. S. 412. Both the Congress and the States have the power to tax transfers or successions in case of death, and this power extends to the taxation by a State of bequests to the United States and to the taxation by the Congress of bequests to States or their municipalities. *United States* v. *Perkins,* 163 U. S. 625; *Snyder* v. *Bettman,* 190 U. S. 249, 253, 254. While a tax on the interest payable on state and municipal bonds has been held to be invalid as a tax bearing directly upon the exercise of the borrowing power of the Government (*Weston* v. *Charleston,* 2 Pet. 449, 468, 469; *Pollock* v. *Farmers Loan & Trust Co.,* 157 U. S. 429, 586), the sale of the bonds by their owners after they have been issued by the State or municipality is regarded as a transaction distinct from the contracts made by the government in the bonds themselves, and the profits of such sales are subject to the federal income tax. *Willcuts* v. *Bunn, supra,* p. 227. See, also, *Burnet* v. *Jergins Trust, supra; Helvering* v. *Therrell,* decided February 28, 1937; and *Helvering* v. *Bankline Oil Company,* decided this day.

In *Group No. 1 Oil Corporation* v. *Bass,* 283 U. S. 279, profits derived by a lessee from the sale of oil and gas produced under a lease from the State of Texas were held not to be immune from federal taxation. This decision was distinguished in the *Coronado* case upon the narrow ground that under the law of Texas the leases effected a present sale to the lessee of the oil and gas in place. In *Indian Territory Oil Company* v. *Board,* 288 U. S. 325, the Court sustained a non-discriminatory *ad valorem* tax imposed by the State of Oklahoma on oil extracted from restricted Indian lands under

leases approved by the Secretary of the Interior, where the oil had been removed from the lands and stored in the owner's tanks and the Indians had no further interest in it.

These decisions in a variety of applications enforce what we deem to be the controlling view—that immunity from non-discriminatory taxation sought by a private person for his property or gains because he is engaged in operations under a government contract or lease cannot be supported by merely theoretical conceptions of interference with the functions of government. Regard must be had to substance and direct effects. And where it merely appears that one operating under a government contract or lease is subjected to a tax with respect to his profits on the same basis as others who are engaged in similar businesses, there is no sufficient ground for holding that the effect upon the Government is other than indirect and remote. We are convinced that the rulings in *Gillespie* v. *Oklahoma, supra,* and *Burnet* v. *Coronado Oil & Gas Company, supra,* are out of harmony with correct principle and accordingly they should be, and they now are, overruled.

In the instant case, we find no ground for concluding that the tax upon the profits of Wyoming Associated derived under its lease from the State constituted any direct and substantial interference with the execution of the trust which the State has assumed, and the decision of the Circuit Court of Appeals to the contrary must be reversed.

Reversed.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration and decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 600.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Mountain Producers Corporation. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

[March 7, 1938.]

Mr. Justice Butler, dissenting.

At least since *M'Culloch* v. *Maryland* (1819), 4 Wheat. 316, the ual form of government resulting from the adoption of the Con- titution has been deemed necessarily to imply that no State may ax the operations of the Federal government in the exertion of owers that the people delegated to it and that, for the same reason, he Federal government may not tax the operations of any State n the exertion of any of its essential functions of government. As o that principle, the urgency of governmental demand for money oes not justify yielding here. No one can foresee the extent to hich the decision just announced surrenders it. The transactions f a State for the purpose of raising money to provide for schools re admittedly within the principle as heretofore it has been under- ood and applied. Now this Court makes it lawful for the United tates to lay tribute upon them.

A few citations will be sufficient to suggest the character of the ange so wrought.

M'Culloch v. *Maryland* held that impliedly the Federal Consti- tion forbade imposition by Maryland of any tax upon the opera- ons of the Bank of the United States within that State. There hief Justice Marshall, speaking for a unanimous Court, demon- rates (p. 426): "1st. that a power to create implies a power to reserve. 2nd. that a power to destroy, if wielded by a different nd, is hostile to, and incompatible with these powers to create d to preserve. 3d. that where this repugnancy exists, that au- ority which is supreme must control, not yield to that over which is supreme."

Farmers Bank v. *Minnesota* (1914), 232 U. S. 516, held that a State cannot tax bonds issued by a territory of the United States; that a tax upon the bonds is a tax on the government issuing them; that such a tax, if allowed at all, may be carried to an extent that will entirely arrest governmental operations. The Court rested that decision upon *M'Culloch* v. *Maryland*, saying (p. 521): "The principle has never since been departed from, and has often been reasserted and applied."[1]

Choctaw & Gulf R. R. v. *Harrison* (1914), 235 U. S. 292, held that, where by agreement with an Indian tribe the United States assumed a duty in regard to operation of coal mines, the lessees of the mines were instrumentalities of the government and could not be subjected to a state occupation or privilege tax.[2]

Indian Oil Co. v. *Oklahoma* (1916), 240 U. S. 522, held that oil leases in Oklahoma made by the Osage tribe were under the protection of the Federal government; that the corporation owning the leases was a federal instrumentality and that therefore the State could not tax its interest in the leases, either directly or by taxing the capital stock of the corporation owning them.[3]

Gillespie v. *Oklahoma* (1922), 257 U. S. 501, held that net income derived from leases like those considered in *Choctaw & Gulf R. R.* v. *Harrison, supra,* and *Indian Oil Co.* v. *Oklahoma, supra,* could not be taxed by the State; for the lessee was an instrumentality used by the United States in fulfilling its duties to the Indians.[4] The Court said (p. 506): "The same considerations that invalidate a

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[1] Citing Osborn *v.* U. S. Bank, 9 Wheat. 738, 859; Home Savings Bank *v.* Des Moines, 205 U. S. 503, 513; Grether *v.* Wright, 75 Fed. 742, 753.

[2] Citing M'Culloch *v.* Maryland, 4 Wheat. 316; Farmers Bank *v.* Minnesota, 232 U. S. 516.

[3] Citing Choctaw & Gulf R. R. *v.* Harrison, 235 U. S. 292.

[4] Citing Choctaw & Gulf R. R. *v.* Harrison, 235 U. S. 292; Indian Oil Co. *v.* Oklahoma, 240 U. S. 522; Howard *v.* Gipsy Oil Co., 247 U. S. 503; Large Oil Co. *v.* Howard, 248 U. S. 549.

As to taxability of gains from interstate commerce, see United States Glue Co. *v.* Oak Creek, 247 U. S. 321; Shaffer *v.* Carter, 252 U. S. 37, 57.

In Burnet *v.* Coronado Oil & Gas Co., 285 U. S. 393, 399, 400, it is stated that Gillespie *v.* Oklahoma has often been referred to as the expression of an accepted principle, citing Metcalf & Eddy *v.* Mitchell, 269 U. S. 514, 522; Jaybird Mining Co. *v.* Weir, 271 U. S. 609, 613; Northwestern Insurance Co. *v.* Wisconsin, 275 U. S. 136, 140; Heiner *v.* Colonial Trust Co., 275 U. S. 232, 234; Shaw *v.* Oil Corp., 276 U. S. 575, 579; Panhandle Oil Co. *v.* Knox, 277 U. S. 218, 221, 222; Carpenter *v.* Shaw, 280 U. S. 363, 366; Willcuts *v.* Bunn, 282 U. S. 216, 229; Group No. 1 Oil Corp. *v.* Bass, 283 U. S. 279, 282, 283; Indian Motocycle Co. *v.* United States, 283 U. S. 570, 576; Choteau *v.* Burnet, 283 U. S. 691, 696.

tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards."

Jaybird Mining Co. v. *Weir* (1926), 271 U. S. 609, held that where mining land was leased by incompetent Indian owners with the approval of the Secretary of the Interior, in consideration of royalty in kind, a state *ad valorem* tax assessed to lessee on ores in bins on the land, before sale or segregation, was void as an attempt to tax an agency of the Federal Government.[5]

In *Burnet* v. *Coronado Oil & Gas Co.* (1932), 285 U. S. 393, it appeared that lands granted by the United States to Oklahoma for the support of common schools were leased by the State to a private company for extraction of oil and gas, the State reserving a part of the gross production, the proceeds of which were paid into the school fund. We held that the lease was an instrumentality of the State in the exercise of a strictly governmental function, and that application of the federal income tax to the income derived from the lease by the lessee was therefore unconstitutional.[6]

To reach in this case the conclusion that respondent's affiliate is subject to federal income tax on the proceeds of its share of the oil received under the lease of state school lands, this Court expressly overrules *Gillespie* v. *Oklahoma, supra,* and *Burnet* v. *Coronado Oil & Gas Co., supra;* and with them necessarily goes a long line of decisions of this and other courts. The opinion brings forward no real reason for so sweeping a change of construction of the Constitution. It is to the plain disadvantage of Indian wards of the national government and school children of the several States; it threatens many business arrangements that have been made for their benefit.

I dissent.

Mr. Justice McREYNOLDS concurs in this opinion.

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[5] Citing Farmers Bank *v.* Minnesota, 232 U. S. 516; Choctaw & Gulf R. R. *v.* Harrison, 235 U. S. 292; Indian Oil Co. *v.* Oklahoma, 240 U. S. 522; Gillespie *v.* Oklahoma, 257 U. S. 501; Howard *v.* Gipsy Oil Co., 247 U. S. 503; Large Oil Co. *v.* Howard, 248 U. S. 549.

[6] Following Gillespie *v.* Oklahoma, 257 U. S. 501. Citing Texas *v.* White, 7 Wall. 700, 725; Collector *v.* Day, 11 Wall. 113; Pollock *v.* Farmers Loan & Trust Co., 157 U. S. 429, 584; Farmers Bank *v.* Minnesota, 232 U. S. 516, 527.